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Part I — Papers Read at Annual Meeting

The Capacity Problem

by

Chester M. Kellogg, vice-president, Alfred M. Best Company, Inc., New York, N. Y.

The subject I have been asked to discuss provides plenty of latitude but I am sure from the whole general tone of this gathering that you are interested in facts rather than fiction. You want to know just how serious the capacity problem is, whether it will become progressively worse, or whether it may already be nearing a satisfactory solution.

Many of you know that the Alfred M. Best Company occupies a unique position. We look at insurance companies individually and at the industry as a whole. Our clients include policyholders—both large and small—agents, brokers, insurance companies and others; in short, almost everyone directly connected with insurance or vitally interested in it sooner or later beats a path to our door. We, therefore, hear many sides of most problems and are in a position to weigh the various factors and sometimes bring them into focus.

At the meeting of the American Management Association earlier this month, getting enough insurance was represented as the buyer's number one headache. We have heard complaints from brokers along the same lines. On the other hand, spokesmen for both fire and casualty companies flatly maintain that there is adequate underwriting capacity to handle all risks that legitimately qualify for insurance. In short there is not what we would call a meeting of minds on the subject.

In the last five years total fire and casualty premium volume has nearly doubled, rising from less than 3 billion dollars to 5½ billion dollars. The inflationary impact of economic conditions on the fire and casualty industry was the impelling force behind this tremendous increase. But, policyholders' surplus rose only ¼ billion dollars. Even more striking are the figures for the last two years. At the end of 1947 policyholders' surplus was actually $100,000 less than at the end of 1945, while premiums had jumped by more than 2 billion dollars. Moreover, volume is still rising although at a somewhat slower rate.

This record growth has subjected the whole industry to acute growing pains. Expansion in any field costs money, but the statutory requirement of maintaining a full unearned premium reserve places an added burden on rapid growth in the insurance field. You gentlemen are certainly aware of this requirement and the resultant extra squeeze on surplus from this source over the past few years. However, few persons outside of the insurance business realize that state law requires unearned premiums to be set up at a figure in excess of the amount which experience shows to be necessary in practical operation.

This statutory procedure correspondingly reduces apparent profit or

increases the apparent loss from underwriting, except where the volume of business written remains static or is decreasing. Unearned premiums are calculated upon the entire amount of the premiums under all policies in force at the statement date with no allowance for expenses incurred in handling new business. In the case of companies operating through agents, the situation is particularly severe as it is customary for the agent to deduct his commission before remitting to the company. Thus, the prepaid acquisition cost has to come out of surplus. Since the premiums are sufficient to absorb both losses and expense, it follows that every well-managed company has an equity in unearned premiums.

The very nature of the insurance business with its reserves for losses and unearned premiums virtually dictates the investment of substantial resources. Low income on high-grade bonds due to artificially depressed interest rates, coupled with lack of appreciation in the market values of stocks, has added what may be termed as second squeeze on surplus.

In the years immediately following the war, when the industry was feeling the pinch of this double squeeze most acutely, a third and more ominous squeeze appeared—substantial losses on automobile business for both fire and casualty carriers. It just seemed impossible to raise rates fast enough to keep pace with the mounting losses. Moreover, every jump in rates boosted premium volume still higher and caused an extra squeeze on surplus because of the statutory unearned premium requirements. In addition, fire companies faced unsatisfactory underwriting returns due mainly to the relationship between insurance coverage to value failing to keep pace with mounting replacement costs. The solution was to increase the amount of coverage. Thus, the industry was caught in a position where the very necessary remedial measures to cure one ailment aggravated the already acute drain on surplus due to reserve requirements.

Very definitely there is a capacity problem for a number of companies and some are rather fully extended. In fact, the fire companies as a group are now writing in annual premiums an amount in excess of their surplus to policy holders and the casualty carriers are writing better than twice their policyholders' surplus.

Naturally, some carriers are writing relatively much more in volume than the average for the industry. However, there are some 170 stock fire companies which could accept 360 million dollars additional volume and still not exceed a one to one ratio. There are 85 stock casualty companies which could accept 330 million dollars additional volume and remain within the two to one ratio. There is also unused capacity in the mutual and reciprocal fields. Unquestionably, additional untapped underwriting capacity exists, and we hold no brief for either the one to one fire fire ratio or the two to one casualty ratio. Many sound companies far exceed these ratios right now, and should supervisory authorities enforce such ratios, there really would be a capacity problem.

Why then has it been impossible for buyer and seller to get together? Primarily, the difficulty seems to stem from a distribution system and a basis of underwriting which have evolved over the years

in an easy market and which have not yet adjusted themselves to a definitely tight market. The inflationary growth of premiums has been so rapid that neither buyers, brokers and agents, nor companies have been able to adjust their thinking and method of operations to the changed conditions.

Normally, individual agents and brokers deal with relatively few companies, and buyers individually deal with a limited number of producers. They contact only a segment of the market. Company underwriters in many cases tend to rely more on their past experience with an agent or broker than on a specific evaluation of a particular risk. Add to this the unprecedented growth, spiraling losses, virtually nonexistent profits and the drain on surplus because of statutory reserve requirements, and it seems a wonder that the situation as a whole has worked out as well as it has.

Faced with this bleak outlook, companies tightened their underwriting — they had to. Some agencies were dropped, some accounts canceled. Companies, that were straining to serivce their own accounts and could not judge how much farther the inflationary spiral would go, were not anxious to acquire new agents and new accounts, particularly when they were afraid that those agents and accounts had been dropped by some other company because of unsatisfactory experience.

In this period of readjustment, perfectly good accounts sometimes have suffered when the company or companies carrying the line reached a point of capacity beyond which management dared not go. Thus, purely capacity cases became mixed up with underwriting cases, and it was almost impossible to tell where one left off and the other began. The fact remains that numerous cases glibly labelled capacity problems were really underwriting or distribution problems.

Among these are certain risks that have never fully cooperated on necessary measures to reduce hazards and are thus not acceptable at present rates. They are having trouble and should have trouble in getting coverage. Other accounts which had become accustomed to shopping in a soft market find shopping in a tight market virtually impossible. The industry cannot be blamed for this. Some companies have reduced their retentions and it is necessary for a large risk or its broker to seek additional carriers. If the risk is good and the rate proper, the coverage has not been impossible to place. Brokers and agents have really had to work to place come lines. We have thus heard less about the producer not earning his commission.

About the only situations in the fire and casualty fields which have not been solved are long-haul trucks and buses, certain jewelry schedules and warehouse risks in which inflated prices have resulted in too high a concentration of value. Most notable in this last category are whisky storage warehouses about which there has been considerable comment. In the long-haul field, it seems to be more a matter of rate than capacity. Certainly no more than 1% of fire and casualty risks have any capacity problem and the solution may not be so much an insurance problem as a problem for the individual risk to adjust its operations to come within the scope of the 99% which find adequate coverage. The average policy-holder is totally unaware that a capacity problem exists.

It is essential for the protection of policyholders that insurance companies maintain a substantial excess of assets over liabilities not only to assure the maintenance of flexibility of operation but as a buffer to absorb the shock of unusual losses. These losses may arise from either the underwriting or the investment end of the business and may be real or not, depending upon circumstances. The loss is real when the underwriting experience turns sour or securities are sold at a loss, but it is only a bookkeeping loss, which may never be realized, if it represents a temporary depreciation in the market value of securities still held. Moreover, a statutory underwriting loss is not real if due entirely to the rapid expansion in volume and consequent increase in unearned premium reserve.

In addition, there are many significant differences among companies due to other factors. Some classes of business are inherently more hazardous than others or are subject to rather wide swings in loss experience; one company may have an excellent spread of business by territory and by class, while another may specialize or concentrate its risks in a single class or locality; different investment policies are followed, ranging from ultra conservative to the more speculative; varying reinsurance arrangements are in force which materially alter the impact of catastrophe losses. This matter of spread of risk goes right to insurance fundamentals. Not only is it desirable to secure sufficient spread within a class of business and territorially but also diversification of business among several classes. Experience has shown that all lines of business never go sour at the same time. Automobile experience may be bad but accident and health or workmen's compensation good. Fire insurance has its cyclical ups and downs, but these do not coincide with the ups and downs in other lines, such as ocean or inland marine. When one line is bad other lines are good so that carriers with a diversified business gain stability. Obviously, the same rule of thumb relationship of premiums to surplus should not be applied.

Moreover, there are participating companies and non-participating, those which obtain business direct and those which operate through agents. In addition, some insurance institutions operate on plans which vary widely from those in general use. To illustrate — a company may write only workmen's compensation business, most or all of which is on a monthly premium basis, so that there exists little or no unearned premium libility. As it has no unearned premium liability there is, of course, no unearned premium reserve and, therefore, no unearned equity.

Then, regardless of what plan of operation carriers may follow, final operating results may vary widely. Two companies may present identical statements—one million dollars surplus, one million dollars unearned premiums and two million dollars annual premium writings. At first glance they appear of equal strength. The fact is, however, that one is much stronger than the other for the reason that its loss and expense ratio averages 85%, while the average of the other company exceeds 100%.

The first company not only has a higher estimated equity in its one million dollar unearned premium reserve but has added materially to its surplus each year, while the second company has been eating

into its surplus because of its unprofitable operations. For practical purposes, the profitable carrier is at least twice as strong as the other.

If all companies held the same type and quality of assets, wrote the same kinds of business in relatively the same proportion and had the same loss and expense ratios, then the volume of premiums written annually would be a safe indication of the amount of surplus required to absorb any abnormal losses from underwriting. However, due to the many dissimiliarities among companies and the necessity for carefully evaluating so many different factors, the ratio of annual writings to surplus cannot be considered the controlling factor but merely one contributing factor to a company's strength or weakness.

If the relationship of premium volume to surplus is not a proper measure of potential capacity, how, then, should we go about getting an answer to this problem? As a point of departure, I will outline some of the broad general principles underlying our own analysis of individual companies and their relative standing in comparison with other companies and with the average of the business.

We begin our analysis very much as any one would analyze the position of any business by determining what the company really owes and how much additional it holds in sound assets at realizable valuations. In short, what is its "safety factor," net worth or excess assets in relation to what it owes.

Surplus to policyholders is the starting point. If assets are overvalued, the reported surplus must be reduced to arrive at the true condition, and the contrary is equally true. In addition to consideration of the valuation of assets and liabilities, the equity in unearned premiums must be determined by a sound formula and taken into account.

Having established the true surplus by careful study of asset valuation and adequacy of claim reserves and then added the portion of the unearned premiums which, in the light of past experience, will not be needed to meet future claims on policies in force, our next step is to ascertain what we call "net liabilities."

In the normal company, "net liabilities" are the statement liabilities, less equity in unearned premiums and less equity or plus shortage in claim reserves. However, in the case of companies which operate on a basis under which they do not collect the premiums until they are earned and, therefore, have little or no unearned reserve, or in cases in which unearned reserve is higher than average, we substitute for the run-off cost of the unearned premiums our estimate of a half year's losses. This procedure automatically adjusts for any difference in methods of computing the statement unearned premium reserve.

It is apparent that what we do, in effect, is to establish on a conservative basis the theoretical liquidating value of each company, and also the amount which would be required to pay all of its debts, including the reinsurance of its business. We then ascertain the ratio of the net worth or "safety factor" to "net liabilities" as the most reliable indication of the present financial strength of the company. (Of course, in arriving at a rate of a company we go much further than this — analyze the adjusted underwriting results and trends, quality of assets, liquidity

position and spread of liability and relate them to the safety factor position.)

I have gone into considerable detail regarding the computation and reasons for ratioing the net worth or "safety factor" to the "net liabilities" rather than to premium volume because this ratio offers a key to the present position of the industry and a sound basis for evaluating recent trends. For example, let us look closely at the casualty branch of the business.

As of December 31, 1947 the ratio of net worth to net liabilities, which we call the "loss-paying margin," was 67.1% for the mutual casualty companies and 91.8% for the stock casualty companies. About ten points of the stock company average was acquired during the past two years through additional funds paid in by stockholders.

The highest ratios ever reached in the casualty field were in 1944 and 1945 when the mutuals had a "loss-paying margin" of 85% and the stock carriers reached 120%, the culmination of an almost uninterrupted twelve-year advance made possible by the most profitable underwriting period in casualty history. The declines in 1946 and 1947 have set both groups back to the levels reported in 1935 and 1936 when the companies were just beginning to recover from the depression lows of 1932 and 1933.

When the relative gains of ten profitable years can be wiped out in two years of unprecedented growth, it is certainly time to ask where the industry is heading and just how much additional volume can safely be accommodated.

It would appear that when the casualty industry averages fall below a ratio of 60%, net worth to net liabilities, some units within the industry are sufficiently below average to encounter difficulties and fail to meet minimum statutory requirements. In 1932 and 1933 the loss-paying margin in the stock field droped to 57.6% and 58.3%, while the mutual ratios stood at 65.9% and 63.5%.

Corresponding ratios in the fire field have always been much higher and justifiable so because of the greater catastrophe hazard. Conflagrations have taken their toll in years gone by and still remain an immeasurable threat. Better construction and improved fire-fighting methods and equipment have lessened this hazard but have not eliminated it. Little more than a year ago Bar Harbor and other sections of New England were in dire peril during a prolonged dry spell. Just a year ago the blizzard that blanketed the East had virtually all city streets blocked completely with snow and stalled vehicles. Fire-fighting equipment could not be moved. Most fire underwriters agree, however, that the greatest loss may arise under the extended cover endorsement. Inaugurated only ten years ago the increasing popularity of the coverage and inflated values have boosted premiums to an estimated 200 million dollars this year. The potential liability is staggering.

The relationship between net worth and net liabilities, or what we term the safety factor, is still not the whole story. It shows merely where the industry stands, not where it is going. For that we must turn again to the three-way squeeze on surplus.

First, what about volume? In the first half of 1948 premiums showed a gain of about 15% as against an unprecedented gain of 30%

recorded in first half of 1947. The same relative relationship seems to have continued in the second half of the year. In short, some of the pressure is off but there is still a definite squeeze.

Second, what about investments? With very few exceptions, investment portfolios are conservative and high-grade. The continued hardening of interest rates will be of ultimate benefit even though market prices on long-term bonds are lower. Stocks have fluctuated within rather narrow limits, but dividends are higher. Unless we get a further break in stock prices or another drop in the peg on government bonds, the squeeze on surplus from investment side is not serious.

Third, what about underwriting? So far this year underwriting has shown improvement. Loss and expense ratios are lower and over-all results are definitely in the black. Fire companies which have reported unsatisfactory underwriting returns for four straight years are expected to show marked improvement for 1948. Earned fire premiums are up an estimated 20%, while fire losses are up only 3%. Expenses are not expected to absorb quite half of the earned premiums so the indicated profit margin will be better than 7%. The squeeze is off on underwriting and the importance of this fact can hardly be overemphasized in view of the very large volume of business currently being underwritten.

While we are on the subject of underwriting, let me quote just one more example to show how fallacious it is to compare surplus with premium volume, unless underwriting profit or loss is taken into account. Let us assume that three companies, each with one million dollars annual premiums, show, respectively 25% profit, no profit and 25% loss. The company making a large profit is adding to its strength day by day, the second company is neither increasing nor decreasing surplus and the third is getting weaker progressively.

The slackening in rate of premium growth, reasonably satisfactory investment returns and better underwriting results have taken a lot of the pressure off surplus. However, there will undoubtedly be occassions in the future of both expansion and shock when extra margins of safety will come in mighty handy. Extra surplus saved many companies in the deflation of the early 30's and extra surplus made it possible for the industry to meet successfully the challenge of inflation that is only now beginning to slacken.

Surplus is needed not only for the economic swings of inflation and deflation but for possible catastrophes, periods of poor underwriting or poor investment returns and for general long-term growth. The staggering growth, due to inflation in the last few years, cannot be expected to continue, but a substantial part of recent growth has not been due to inflation alone and the long-term outlook is something to be considered in any discussion of capacity.

There are more automobiles in this country than we have ever had and still the demand is not filled. Far more automobiles are insured than ever before due to additional state auto financial responsibility laws and to a general increase in the awareness and acceptance of automobile insurance. Before the advent of really stringent financial responsibility laws, only about one-quarter of the automobiles were insured against liability and property damage.

In the twenty states now having automobile financial responsibility laws requiring security for past accidents, an estimated 75% to 85% of automobiles are insured. Possibly one-third of the automobiles in the other 28 states are insured. Over the next several years there should be a substantial further advance in automobile premiums because of new laws, new cars, finance requirements, greater public acceptance and possibly higher rates. That is only one line.

Just coming over the horizon is an entirely new source of business. So far only Rhode Island, California and New Jersey have adopted non-occupational disability laws, but other states are planning to follow suit and in time such legislation may spread to all states just as workmen's compensation did. Should all states adopt this type of social legislation, the annual premiums would exceed one billion dollars. In some states, it will be handled through a state fund and the life insurance companies will also bid on it to protect their group business. However, casualty carriers can acquire a very sizable chunk if they wish, and many may wish to do so to protect and supplement their workmen's compensation business.

The above examples are from the casualty branch of the business. What is going to happen when it loses its separate identy and becomes so thoroughly entwined with the fire branch of the business through multiple underwriting and broad packaged comprehensive policy contracts that it will be impossible to tell where one leaves off and the other begins? We already have overlapping in automobile and aircraft policies and the next big commingling may well occur when all of the hazards of home ownership are combined in a single householder's policy.

The shift to multiple underwriting may come swiftly and rather easily as today fully 70% of the casualty business is underwritten by companies with affiliated carriers in the other field. Broader contracts and broader fields are bound to broaden the outlook of insurance executives and open additional avenues of business as yet virtually untapped.

Having touched the past, the present and the future to show the need of additional surplus to keep pace with future growth and guard against contingencies, let's return to the present and see just how managements have faced the capacity problem. As an example, let us analyze briefly just what general policies have been followed in the mutual casualty field as they typify what has been done in other branches.

Of the 155 mutual casualty carriers, 68 are in the dividend-paying classification and 87 do not pay dividends to policyholders. The non-dividend companies write in annual premiums an amount approximately two and one-third times their surplus to policyholders, while the dividend payers have a ratio of three to one. This is entirely logical for the dividend-paying carriers have an extra margin of safety in their dividends. They are operating on a profitable level with a margin to absorb any unforseen shock and in case of necessity could either reduce or temporarily discontinue the dividend. Some carriers have reduced or discontinued their dividends in the past few years and encountered no dire consequence or loss of faith by their policyholders.

The factors of size and spread of business have also been very generally

recognized by management. The larger the company and the greater its spread of business by territory and by class the less surplus it needs proportionately to fully cover contingencies. For example, the average loss-paying margin (ratio of net worth or safety factor to net liabilities) in the mutual casualty field at the end of 1947 was 67.1%. The ten largest mutual carriers, each writing in excess of 12 million dollars in annual premiums, had a ratio of only 62.4%. The next nine, writing between 5 million and 12 million dollars annually had a ratio of 65.5%; those writing between one million and two million, 70.9%; between one-half million and one million, 76.1%; and the twenty smallest carriers, those writing less than one-half million dollars in annual premiums, had a ratio of 105.3%. In the stock field, the same general pattern prevails and even to a greater degree as the stock carriers writing less than one-half million annually had a loss-paying margin of 308.7%. Similar relationships prevail in the fire field.

We feel very strongly that there is a lot more to the capacity problem than can be evaluated by the ratio of premium writings to surplus and that most insurance company managements, by taking into consideration the other important factors peculiar to their own position and method of operation, have met the problem successfully to date and will continue to meet it successfully in the future. By recognizing that a capacity problem exists and considering carefully all factors involved, very few managements will go overboard.

Theoretically, a company could write itself out of business because of the statutory requirements for unearned premiums but actually I have never heard of a company being placed in receivership because it had too much *good* business. Companies fail because of poor quality assets, unprofitable business or catastrophe losses. Sometimes they fool themselves or the public for a while by being overly optimistic on estimates of loss reserves, but when loss reserves prove inadequate and liabilities exceed assets, it is because the quality of the business is poor. If the business had been good, the reserves probably would have been adequate. Thus again, it is emphasized that volume alone is not the test.

Certain minimum standards of safety are, of course, essential but such standards must be applied intelligently. There is no single rule of thumb method that will stand up under the varying methods of operation. Common business sense must be applied.

A Property Insurance Executive Views Education for Insurance on the University Level

by

Warner C. Danforth, Boston University and Employers' Group, Boston, Mass.

When I was confronted with the topic assigned to me for this discussion, "A Property Insurance Executive Views Education for Insurance on the University Level", I realized that any ideas that I had on this subject would be biased. This is due to the fact that I represent the Employers' Liability Assurance Corporation, Ltd. of London, England, as Superintendent of the Education Department, and as the Acting Head of the Insurance Department of Boston University, College of Business Administration.

However, earlier in the season we had decided to conduct a survey among the insurance companies and agencies of this area in an effort to evaluate the work we were doing at Boston University. We formulated a questionnaire and sent it out to the proper executive of each company that had sent previously, or were at the present time sending, students to any of our courses. We endeavored, in so far as possible, to include not only those companies who were employing graduates of our full time program but also those who had encouraged their employees to take individual courses in the evening school. It developed that the information received from this survey should be of general interest to insurance educators everywhere. We are all interested in improving the relationship between the universities and the insurance companies for two reasons: First, they are our greatest potential market for employing of our graduates; secondly, they are almost our only source of part-time students. Again we all, as educators, are interested in making our curricula as rich as possible and our methods pedagogically sound.

In setting up this questionnaire we endeavored to cover the points which would be of help to us in determining how our present courses were being received and what advantages had accrued to those employees who had completed them. We were also interested in the opinion of those executives as to what additional courses, or types of courses, they considered to be valuable for their employees. Furthermore, we also tried to discover whether or not there was any correlation between our program and the educational policies of the individual companies. That is to say, we were anxious to know wherein we duplicated or augmented their own employees schools.

The questionnaire is as follows:

1. What insurance courses have helped your employees in their work?

2. How do our courses fit into your total program of employee training?

3. Would other advanced courses in the use of manuals be valuable? What other lines would you suggest?

4. What advanced courses in the study of Insurance lines would be of assistance?

5. Any suggestions or constructive criticism?

The replies were interesting because they were so varied. This brings us face to face with the real problem of insurance education — how best to serve the needs of the insurance companies when they all want something different.

Perhaps the best way that we can approach this problem is to consider some of the replies and then let you decide how you might apply them to your individual situations.

I feel that each of you would have received replies similar to the ones we are about to consider no matter where the questions were asked. One general trend was the request for more manual work.

> "I again say that you cannot spend too much time on the manual rules. It is essential for an underwriter to have a complete understanding of the manual rules and the 'why' and 'wherefore' of these rules."

Another general request was for liability, burglary, and workmen's compensation courses with the use of manuals in each course. Yet one reply was as follows:

> "It would seem to me that insofar as students who are actively engaged in insurance work are concerned, the use of the manual would be something that they would pick up in the course of their daily work. My observation is that good insurance men, like good football players, are developed from a thorough understanding of the fundamentals, and that once they have this knowledge, it is very easy for them to progress satisfactorily as respects to other requirements."

We have an advanced course on automobile insurance and again different points of view on this course.

> "In discussing this quesstionnaire with two of our employees attending your courses they both would be interested in learning the rating of Massachusetts automobile risks. I presume this will be given before the end of their course. They seem to have absorbed a good working knowledge of the out-of-state automobile."

And the other side:

> "I feel that a complete knowledge of the manual of rules and rates is of paramount importance in arriving at an adequate premium for a given exposure. I would suggest that more time be spent on lines other than automobile as obviously the automobile situation in Massachusetts is more or less a cut and dried matter."

And again we have this comment;

> "Advanced courses in the use of manuals would not be of any

value in that we use our own mutual manuals. This manual is somewhat similar to that used by stock companies belonging to the National Bureau of Casualty Underwriters, but is not sufficiently complex to warrant an advanced course. Nor would there be a sufficient number of persons interested to make it worth the University's while."

These quotations are adequate to convince us that we as educators do have a real problem.

In evaluating these replies it is necessary always to keep our eyes on our objectives, namely, general courses designed to serve the broadest needs of the greatest number of people, and advanced specialized courses to meet the requirements of certain groups. Accordingly we are planning to offer advanced courses in workmen's compensation and liability coverages next fall. Manual work is, in my opinion, a different matter. Here we shall continue to keep to the middle of the road, since too detailed manual work would consume considerable time and detract from the general interest in the course.

In addition to actual subject content these questionnaires brought forth some suggestions as to methods, and also that most subtle of results — the motivation of the individual — so that he or she would become a valuable member of the organization, not one merely with his eye on the top of the ladder and no interest as he was going up.

I should like to quote a few of these which may be of assistance in conducting insurance courses.

> "Our trainees who have taken your courses suggest that more problems which involve interpretation of policies should be given. They feel that the emphasis has been placed on the understanding of the policy but little time to the problems met in the field."

Another suggestion from a large insurance company, and I quote:

> "A study of policy coverage, endorsement wording and rating methods invaluable. Also new state and federal regulatory laws affecting all insurance companies should be touched upon."

A statement from another large insurance company executive reads as follows:

> "Since it is not possible for anyone to know too much about his business, I should say that an advance course would be desirable provided again that the knowledge acquired is put to use by the student. Some students have felt that having exposed themselves to a certain amount of knowledge, through study, has qualified them to become insurance executives. They have overlooked the fact that unless they use their knowledge as a more effective performance it is of no value to them or their employers."

This statement leads me to believe that we who are instructors must always be mindful of our responsibility to our students. We must encourage and yet at the same time we must not give them false hopes that our insurance courses are a guarantee to an executive position in some insurance company.

All the replies were not complementary — as witness to one I now quote:

> "I have not recommended your present course (evenings) as the reports in all cases have been, that very little has been derived from

it, except in a general way. I initiated our own training program — recommended books, and held weekly (or oftener) sessions in specific lines, from which considerable benefit has resulted. This is a broad field and educational institutions could improve their techniques."

I have not yet checked to see what course he refers to, for we offer a variety of evening courses. All of these courses are taught by men active in the insurance business and the content of all courses clears in a general way through the head of the department.

I might mention here that it is our policy at Boston University to employ as instructors only men with a broad practical background as well as academic standing. In fact we would prefer men who actually retain an active relationship in some company or agency.

I would like at this time to pay tribute to these company executives who have furnished me with their frank opinions. They have helped us in many ways — several of the large insurance companies in the Boston area register their approval of our program by supporting us in a very tangible way. This support has been in the form of tuitions paid for their employees who have been willing to avail themselves of the opportunity for advancement by giving one or two evenings each week to these insurance courses. The most successful plan is in those cases where the companies paid 50 per cent of the tuition at the time of registration with the agreement that if the course was completed with a passing grade the company would then reimburse the employee for the remainder of the tuition.

In conclusion I should like to make two suggestions which are, in my opinion, important factors if our university programs of insurance education are to continue to play an important part in the field of insurance. First, we must ever be alert to the needs and desires of the companies and employees whom we try to serve. Secondly, we must make our courses specific and practical. One of the best ways of meeting this last requirement is to employ as instructors men who have been and who continue to be active in the field of insurance.

A Life Insurance Executive Looks at the Academic Program of Education in Insurance

by

H. G. Kenagy, Vice Pres., The Mutual Benefit Life Insurance Company

My presence on this panel is probably due to the fact that, as chairman of the Agency Management Association's Committee on Relations With Colleges and Universities, I've been saying and writing some things about the need for greater mutual understanding and cooperation. Our committee has become firmly convinced that the life insurance companies could profit from a much larger infusion of college trained people and, in a forthcoming report, is urging companies to compete with other industries for our share of the college crop. We are advocating experiments with summer employment of undergraduates, with scholarships and internships, and with special plans for maturing those graduates who go into sales work. Every company that employs even a small number of college graduates each year needs a Director of Selection, Training and Maturation whose job it would be to guide the whole process of choosing desirable college graduates and growing them up as rapidly as possibly in the work for which they are best fitted.

At present only a few life insurance companies are recruiting new personnel from campuses. Still fewer are seeking the product of your insurance courses. Our business isn't sold on the value of collegiate instruction in insurance. That's partly due to our lack of knowledge of what instruction you are giving. We hear of the great spread of insurance instruction on our campuses but we don't know what you are attempting to teach nor what your objectives are. If you expect us to provide a market for the product of specialized vocational courses, you need an effective plan for keeping us fully informed.

I suspect that it will be a long time before our companies will be much interested in your efforts to prepare students for jobs requiring technical knowledge or special skills. This will be especially true in regard to sales jobs. Our companies are still largely convinced they cannot use boys fresh out of college for selling, regardless of how much they may have learned about life insurance and its uses. Those who are willing to experiment with a growing-up plan, give little if any preference to sudents who have majored in insurance. They believe that special knowledge is best acquired in connection with the learning of vocational skills. Since the required skills are determined by individual company policies and procedures, they must be learned on the job. So, our companies see little value at present in vocational courses.

Whether this attitude is wrong or right, it would appear that, if you want your insurance courses to have any vocational or career values, you ought to have reliable machinery for pre-determining their acceptability and value. Perhaps you need an advisory committee composed of company educational directors and personnel men. Perhaps you need a committee of your own to study the jobs which are held by college graduates in the early years after graduation, to discover how much of the knowledge required is possible content for college courses. The expansion of the insurance curriculum without such guidance or research would seem likely to prove wasteful—of effort, money and time.

There is an area, however, in which there can hardly be any doubt of the value of college instruction in insurance. I refer to the basic or survey courses designed to give students a broad understanding and appreciation of the institution of insurance and the part it plays in our economic life. The rapid spread of these courses and the evidence that the quality of instruction is constantly improving, give us in the sales and public relations divisions of our companies real satisfaction. I realize that the content and teaching of some of these courses are not exactly what we would like to see but ,as the Huebner Foundation and other teacher-training agencies increase their output, the quality will improve. We would like to see the introduction of textbooks or other teaching material which put more emphasis on the economic, particularly the consumer, aspects of insurance, and less on the technical, scientific and legal aspects. Some textbooks give less than 25% of their content to the theory and purposes of insurance—to its manifold services to our economy.

I can probably best indicate my own thinking by assuming that I were a college teacher of *life* insurance and could decide the content of my own courses. I would have two major purposes: (1) securing an understanding of life insurance, by my students, as the foundation for a sound program of personal, family and business economics: (2) establishing the indispensable role which life insurance plays in our economic system and in preserving the basic principles of our democratic way of life

It is becoming increasingly true that life insurance is the only means whereby most men can attain financial salvation for themselves and their dependents. As a teacher I would keep in mind the sober probability that, for 80% of my male students, life insurance would prove to be their only provision against the hazards of dying too soon or living too long. Probably an even greater proportion of my female students, whether they became homemakers or went in for independent careers, would someday be dependent on income from life insurance. I couldn't help rubbing my students' noses in those significant facts as a stimulus to the learning process. Then, too, I would be conscious of the fact that the average family makes a muddle of its financial affairs. It wouldn't be my province to teach a full-fledged course in money management (It seems to be nobody's province!) but I would certainly teach life insurance as the core of a sound system of family economics. I would put my students in a position to become intelligent buyers and owners of life insurance as the basis for a long-range financial or estate-building

program. With this foundation I'm sure it would be much easier to arouse interest in the principles of life insurance, the functioning of companies, the services of the agents, along with enough of the technical aspects to establish the scientific basis.

Teaching the functioning of insurance in the development and preservation of our private enterprise economy would be an absorbingly interesting and rewarding task. Believing that our free enterprise system, which has been responsible for our country's superior level of general welfare, must be preserved and strengthened, I would feel that the part which insurance plays could not be too fully taught, too strongly emphasized. Free enterprise cannot exist without insurance because enterprise involves risk and insurance makes risk-taking possible.

As a corollary, there is the role that individual ownership of insurance, particularly life insurance, plays in our democratic society. The man who owns life insurance, and knows why, has accepted personal responsibility for the welfare of himself, his dependents and his business. He is not depending on government or on any other social agency. The more people who voluntarily accept and underwrite such responsibility, the stronger our democracy will be. Private initiative and individual responsibility are the cardinal principles of our American way of life. As a teacher I'd get a tremendous satisfaction from helping my students understand how life insurance helps make these principles dynamic and enduring.

Report on Survey

of

College and University Courses in Insurance and Related Subjects

by

David McCahan, Executive Director, The S. S. Huebner Foundation for Insurance Education

The extent of college and university education in insurance, on which I have been asked to report to you, has recently been measured in a comprehensive survey conducted by The S. S. Huebner Foundation for Insurance Education. Some fifteen hundred colleges, universities, law schools, technological schools, and even junior colleges, representing virtually all institutions in this country above the high school level, were asked to cooperate by furnishing detailed information on their insurance offerings in 1947-48, whether intended for undergraduate, graduate, extension or evening students. They were also asked to supply certain data pertaining to their future plans, and to offer suggestions with respect to possible aids for enhancing the effectiveness of insurance instruction. Diligent follow-up efforts were made to assure replies from all institutions where there was any reason to believe that insurance courses were being given. The data thus obtained are being published in a special monograph.[1]

Since the various parts into which this monograph has been divided will indicate the general nature of the course classification employed, and something of the range of topics covered, I am listing the principal divisions:

Introduction

Part I—General or Survey Courses in Insurance Principles or Risk and Risk-Bearing

Part II—Courses in Life Insurance and Related Fields

Part III—Actuarial Science and Mathematics of Life Insurance

Part IV—Courses in Property Insurance, Casualty Insurance and Related Fields

Part V—Insurance Law

Part VI—Other Insurance Courses

Part VII—General Information Pertaining to Insurance Instruction

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1 "College and University Courses in Insurance and Related Subjects," David McCahan and Morris Hamburg, published by S. S. Huebner Foundation for Insurance Education, 3924 Walnut St., Philadelphia, Penna., 1949.

Part VIII—Future Plans and Needs
Part IX—Summary
Appendix A—Courses in Business Subjects Closely Related to Insurance
Appendix B—Teachers of Insurance
Appendix C—Summary from "Education and Training Activities of Insurance Companies and Associations"

The full report of this survey is entirely too voluminous for presentation here but certainly excerpts from the "Summary" section should suffice to give a fairly good idea of the current situation. These follow, with the wording modified wherever necessary to eliminate cross-referencing to other sections of the complete report.

Aggregate Courses and Enrollment—The large extent to which insurance is already represented in America's higher institutions of learning is clearly indicated in the fact that 250 colleges and universities offered in 1947-48 a total of 853 courses, of which 237 were primarily intended for the general lay student. Enrollment figures for 1947-48 were not reported for 145 courses but the combined enrollment for the others totalled 41,009. This enrollment was distributed among the various types of courses as follows:

Type of Course	*No. of Students*	*Per Cent*
General or Survey	18,498	45.1
Life and Related	7,253	17.7
Actuarial Science	319	0.8
Property and Casualty	8,468	20.6
Insurance Law	4,335	10.6
Social Insurance	1,775	4.3
Research and Seminars	149	0.4
Miscellaneous	212	0.5
	41,009	100.0

These 250 institutions offered 853 insurance courses with aggregate student class hours of insurance instruction (to the extent reported) of 1,763,447 in 1947-1948. The average enrollment per course for those courses in which enrollment was reported was 57.9.

Hours of Instruction—The distribution of class hours for all types of insurance courses covered in the survey are as follows:

Class Hours	*Number of Courses*
Under 30	18
30 to 44	234
45 to 59	306
60 to 74	95
Over 74	37
Not Stated	163
	853

Class of Students—Of the courses covered in this survey, 509 were for undergraduate students but graduate students were admitted to 142 of these and evening or extension students to fourteen. Eighteen were offered only for graduate students and 242 others only for evening or extension students. Seventy-six courses were for professional law school

students. The class of students for which the course was given was not stated in eight instances.

Year of Adoption—A large number of insurance courses have been initiated within recent years. The effect of World War II is plainly seen in the table below. The number of insurance courses initiated during the years 1936 to 1940 was 110. The corresponding figures for the war years 1941 to 1945 was only sixty-six. There appears to have been a rapid resurgence, however, in the number of insurance courses subsequently inaugurated, with 147 courses reported to have been started since 1946. The distribution of the 853 courses as to time of adoption follows:

Year of Adoption	*Number of Courses*	*Per Cent*
1910 and before	20	2.3
1911 to 1915	15	1.8
1916 to 1920	27	3.2
1921 to 1925	30	3.5
1926 to 1930	76	8.9
1931 to 1935	58	6.8
1936 to 1940	110	12.9
1941 to 1945	66	7.7
1946 to 1948	147	17.2
Not Stated	304	35.7
	853	100.0

General Information—Summary statements with reference to relative development in different institutions, opportunity for specialization, research requirements for insurance majors, groups for which insurance is a required subject, availability of non-insurance courses of C.L.U. and C.P.C.U. programs, and teachers of insurance appear in the full report.

Future Plans and Needs—Some fifty-one courses are now in the blue-print stage. As regards other plans, a number of institutions reported that lengthening of existing courses is contemplated, usually by making them two semesters in duration rather than a single semester. Some college and university officials reported that they are planning to make insurance a required subject for additional groups of students and a number further stated that they hoped to work out in course of time a complete curriculum for C.L.U. and C.P.C.U. preparation along the lines presented in a paper entitled "College Education for Insurance: A Minimum Program,"[2] which sets forth the joint views on this subject of the deans of the American College of Life Underwriters and the American Institute for Property and Liability Underwriters, Inc.

In many instances, reports on plans for the future were qualified by statements that their fulfillment would be dependent upon the availability of well qualified teachers.

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2 Journal of American Association of University Teachers of Insurance, 1947, pp. 5 to 24.

Inquiries as to needs for various types of materials which presumably might be helpful in improving insurance instruction were centered about: (1) textbooks, (2) visual and audio visual aids, and (3) other aids and publications.

Some Significant Comparisons with 1938-39.

The Foundation survey paralleled in many respects a survey conducted by the American College of Life Underwriters on insurance instruction offered in 1938-39.[3] Moreover, as the total number of colleges and universities to which questionnaires were sent, and from which questionnaires were received, in 1938-39 and 1947-48 did not differ appreciably, and since there appeared to be no marked difference in the amount of information reported in those two academic years, the following conclusions appear justifiable:

1. Although not many more institutions offered insurance courses in 1947-48 than in 1938-39, the number of such courses offered per institution has increased appreciably. Moreover, the aggregate number of student class hours of insurance instruction has increased at a much greater rate than has the number of insurance courses offered or the number of institutions offering insurance courses. These conclusions are based on a comparison of the following summary figures:

	1947-48	*1938-39*
Number of institutions reporting courses	250	235
Number of courses reported	853	584
Reported enrollment	41,009	18,249
Reported class hours	1,763,447	782,137
Average course enrollment in those courses for which enrollment was reported	57.9	36.5

Such comparisons are of course suggestive as to the future, but by no means conclusive. The 1947-48 figures have doubtless been influenced by the large post-war enrollment in higher educational institutions, attributable in substantial part to the veterans who are utilizing "G.I. Bill" educational benefits. On the other hand, sight must not be lost of the upward movement which had set in prior to the war and also of the fact that many insurance courses were suspended during the war.

2. As respects number of courses offered, the greatest relative increases were in the property and casualty field, research and seminar courses, and in life insurance and related subjects. Of course, in the case of research and seminars, the effect of computing the relative increase on a small base should be considered. The relative increase in the reported number of courses in general insurance is approximately equal to the relative increase in life insurance and related fields.

As respects number of students enrolled in insurance courses, the greatest relative increases were in general or survey courses, property and casualty courses, and research and seminars. Again the qualification with respect to research and seminar courses should be taken into

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3 See "College and University Courses in Insurance and Related Subjects," David McCahan and Anna M. Kelly, published by the American College of Life Underwriters, Philadelphia, Penna., 1940.

consideration. The comparative figures follow on which these comments have been based.

Types of Courses	*1947-48 No. of Courses*	*Enrollment*	*1938-39 No. of Courses*	*Enrollment*
General or Survey	237	18,498	157	6,167
Life and Related	199	7,253	130	4,352
Actuarial Science	28	319	24	448
Property and Casualty	216	8,468	107	3,215
Insurance Law	97	4,335	73	2,158
Social Insurance	43	1,775	37	1,083
Research and Seminars	15	149	9	67
Miscellaneous	18	212	7	90
	853	41,009	544*	17,580*

* Figures for forty non-comparable courses are not included.

3. In number of hours of instruction per course, the comparative distribution of class hours was as follows:

Class Hours	*Number of Courses 1947-48*	*1938-39*
Under 30	18	22
30 to 44	234	218
45 to 59	306	203
60 to 74	95	69
Over 74	37	15
Not Stated	163	57
	853	584

An analysis by types of courses shows that the modal class was the same in all types for the two periods except in the "Life Insurance and/or Related Fields" group where it increased to "45 to 59" from "30 to 44."

4. The class of student for which courses were given:

Class of Student	*Number of Courses 1947-48*	*1938-39*
Undergraduate	354	281
Undergraduate and Graduate	141	81
Undergraduate and Evening or Extension	13	23
Undergraduate, Graduate, and Evening	1	3
Graduate	18	19
Evening and Extension	242	110
Law School	76	67
Not Stated	8	0
	853	584

5. Other comparisons of significance may be briefly summarized as below noted:

	1947-48	*1938-39*
Institutions offering instruction two or more main fields	126	99
Specialization permitted for undergraduate students	37	16
Specialization permitted for graduate students	12	7
Insurance course as requirement for one or more groups of students	73	62
Number of Teachers:		
Full-time (one-half or more of teaching load to insurance)	83	38
Full-time (less than one-half of teaching load to insurance)	224	258
Part-Time	160	88
Number of new courses planned	51	32

A University Professor's Viewpoint

by

Robert I. Mehr, University of Illinois

I.

We have just been told (1) that the life insurance industry in general does not want college graduates directly from the campus; (2) that instead of attempting to turn out career men in life insurance, the universities should restrict their activities to teaching the consumer aspects of life insurance and to showing the important role played by life insurance in the economic system; (3) that in teaching property insurance, our universities do not go far enough in presenting materials on "how to do the job"; that students supposedly majoring in insurance are graduated without even knowing the simple technique of reading the rate manuals; (4) that the universities have been lax in their failure to recognize insurance as a profession along side of law, and accounting.

First, I should like to comment on these points.

(1) If the experience in other universities is like that at Illinois (and I have every reason to assume that it is), the problem is not one of interesting the companies in taking the graduates but one of interesting the students in accepting employment in the insurance business. There are many more demands for qualified university graduates in insurance than can be filled by the universities. The major placement problem in insurance on the part of the universities is that of keeping the interest of the agencies and companies that fail to employ one of the graduates.

The life insurance agencies that are successful in employing men from our campus are those that are willing to invest both time and money in them. Our students feel that the general agent should be selective; that he should not employ men whose chances of success are not high. They are convinced that once the general agent has chosen a man, he should be willing to back his opinion by offering a guaranteed salary to the one selected. Our students want not only a fair starting salary, but adequate training and supervision. They do not want to ally themselves with agencies that have bitten off more than they can effectively manage.

(2) By far the majority of students enrolled in our insurance courses are taking these courses because (a) they are required to do so or (b) they want to become better buyers of insurance or (c) they want to learn more about the place of insurance in our total economy. Only a small number are actually interested in making insurance a life's work. Many more students come out of these courses than enter them with a strong interest in an insurance career. The interested students themselves ask for more courses, and where the manpower is available and the educational philosophy favorable, new courses are developed. It is in these advanced courses that the career aspects of insurance should be taught, but the number of these advanced courses necessarily must be restricted

in order that the student may have ample time to take the broad liberal courses so essential to the college-trained man. The content of these courses must also be restricted to what I would call academic rather than vocational, or education in the "whys" rather than training in the "hows". By this, I do not mean the so-called theoretical as against the practical, for our theories are of no value if they cannot be applied in non-academic life.

Now let's get back to the basic course in life insurance. What should we teach? I agree that we should teach more of the consumer aspects of life insurance and that we should explain the place of life insurance in the American economy. But in doing this our job is not to sell life insurance, i.e. it is not to break down buying resistance, but to lead to more improved insurance buymanship on the part of the general public. This, in turn, will require improved salesmanship on the part of the agent. There will be less twisting of needs to fit the policy and more of selecting policies to fit the needs. American universities are gradually turning out more and more informed buyers of insurance who can recognize the life insurance agent who is trying to bluff his way into a sale. To these men, the career agent is at a premium.

In teaching the place of insurance in the American economy, again our jobs as insurance teachers are not those of public relations men for the insurance industry. We must teach our students how to recognize the services of insurance to our economy but in doing so we must take an inquiring point of view. Are there any disservices? Are there any other agencies which provide the same services? We must inquire into the ways in which insurance can contribute more to our economy. We must be completely impartial, for if we became tools of the insurance business we lose our value to our university.

(3) With respect to the criticism that our universities do not go far enough in presenting materials on "how to do the job", — that the universities turn out men who know a lot about insurance without being able to do anything — let me state my position, which I know to be that of most of my colleagues. It is the function of the university to teach the student how to "cut the bait". It is the job of his prospective employer to teach him how "to fish". To attempt to teach a man to fish in a vacuum pond is a waste of time of both teacher and student. If insurance companies would be willing to employ our students in the summer preceding their senior years and teach them applied insurance practices, we, as professors ,would be happy to make the necessary arrangements.

By these remarks, I do not mean that we cannot consider practical problems in the classroom. The use of concrete problems is an effective teaching device for affording students practice in analyzing problems and making decisions. But we operate in somewhat of a vacuum. For the student who has had no practical experience, the limit of absorption of practical situations is not too great. Even were universities to consider practical vocational training as one of their goals (and most universities do not), they would face a definite limit on the amount of such training which could be given effectively. The final responsibility for training rests with the industry, not the universities.

This is not to say that the universities cannot help industry with

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PROCEEDINGS

of the

THIRTEENTH ANNUAL MEETING

CLEVELAND, OHIO

December 29, 30, 1948

ORDERS FOR PUBLICATIONS AND INQUIRIES REGARDING MEMBERSHIP SHOULD BE ADDRESSED TO THE SECRETARY OF THE ASSOCIATION, SCHOOL OF BUSINESS, INDIANA UNIVERSITY, BLOOMINGTON, INDIANA.

This issue of the JOURNAL was prepared for public issue by the Secretary-Treasurer, J. Edward Hedges

the job of training. Many of the universities represented here today are both willing and equipped to organize and administer non-credit specialized evening and extension courses in insurance, they are willing to cooperate and take the lead in establishing conferences and institutes. But the vocational aspect of university training belongs in the extension or evening divisions of the university and should be offered without academic credit to men and women in the business. The courses may be taught by men who are actually doing the job.

(4) The final major point made by speakers this afternoon is that the universities have been lax in not accepting insurance as a profession and offering professional training. Let me say that the industry itself has been lax in accepting the professional concept. I do not believe that the majority of men and women in the insurance business want to professionalize it. To do so would mean strengthening licensening requirements, a new code of ethics, and the acceptance of strong educational requirements. Universities have accepted the professions of law, medicine, and accounting because these professions have accepted the universities. The examinations and requirements for practice in these fields in many cases require university education. Often university educators have a hand in making out the examinations. It is true that we have the CLU and the CPCU examinations in which a great university plays a large part but these degrees have not been widely accepted by the industry, they are not recognized by the states, and very few members of the public know or care what they mean. A few prospective employers of our students have been known to joke about university education in insurance, and telling our students that in order to be a success they must first forget what they learned in college.

Men and women in the insurance business who wish to professionalize it must first sell the idea of professionalization at home and then to the public. A business does not become a profession simply by calling itself one. It becomes a profession by conducting itself in such a manner that the public looks upon it as a profession. At present at least some segments of the public look upon insurance with some misgivings. These prejudices have to be removed before any progress can be made toward professionalization — if professionalization is wanted. One way to remove these prejudices is for insurance men and women to wear the professional cloak in all of their transactions. Universities today are prepared to help prospective insurance men to develop the professional cloak. Universities, however, cannot professionalize the business.

II.

Now that I have discussed the comments which have been made by other panel members, I should like to take the remaining time to tell what our students think about the insurance business. I took a sample of 236 students in our College of Commerce and asked them certain questions, the answers to which I know you will find very interesting. These students were made up of 62 accounting majors; 62 marketing majors; 52 economics majors, of which 18 were concentrating in insurance; 43 management majors; and 17 majors in a group of miscellaneous subjects.

Ninety-four of these students had taken one or more courses in insurance.

As to what they are looking for when they graduate: 59 want to be accountants; 50 want sales positions; 22 want positions in business or industrial management; 14 want personnel work; 11 want jobs in general insurance agencies; 10 want to be life insurance salesmen; 7 want non-selling jobs in insurance companies; 7 want advertising positions; 6 want to be purchasing agents or buyers; 5 want to go into retailing; 4 are going into "Dad's business," 3 want to be professors, 3 plan to be lawyers, and the rest want positions as government economists, traffic managers, real estate brokers, labor union administrators, statisticians, etc. or are undecided.

Over 70% of these men can be hired for a starting salary of $250 a month and approximately the same number will be satisfied if they are making $5,000 a year five years after graduation. They are willing to take less than $250 a month on a training program.

The college senior of today grew up during the period of economic insecurity of the '30's and the political and social insecurity during the war and post war period so it is only natural that they place security high on their list of what they want most out of a job. Over half of the students mentioned security of income as a very important job consideration. Almost an equal number also listed enjoyment of work, self-expression and job satisfaction as important factors. Sixty-eight mentioned chance for advancement; 66 included income possibilities; 23 mentioned good working conditions and likable associates; 16 want independence of action; 16 want prestige; 13 said they wanted to contribute to society; 13 wanted adequate free time; 10 wanted to deal with people; 10 wanted their work recognized and 11 want a job in which they have a responsibility. Some do not know what they want.

Now let us see what these people think of the insurance business as a life's work.

(1) *Interest in life insurance selling*

Out of the 236 students interviewed, 22 (9.3%) expressed a real interest in selling life insurance. Nineteen of these 22 had taken an insurance course. In summary, twenty percent of those interviewed who had taken insurance courses said they had a real interest in selling life insurance. Only 2% of those who had taken no course in insurance expressed a strong interest in becoming a life insurance agent.

A total of 116 students expressed a definite disinterest in selling life insurance. This represents 49.2% of the number interviewed. These disinterested students are made up of 28 who had taken a course in insurance and 88 who had not. On a percentage basis, 29.8% of those who had insurance courses were disinterested in life insurance selling as a career, while 62% of those who have not had a course were definitely disinterested. The remaining number of students in each category was either only mildly interested or undecided.

(2) *Interest in Property—Casualty Insurance selling*

The information found relative to student interest in property-casualty insurance selling may be presented in tabular form.

	Students who have studied insurance		Student who have had no insurance course		Total	
	Number	Percentage	Number	Percentage	No.	Percent.
Definitely Interested	18	19.1	2	1.4	20	8.5
Definitely Disinterested	24	25.6	87	61.3	111	47.0

The remaining students in each class are either only mildly interested or are undecided

(3) *Interested in Non-Sales Employment in Insurance Companies*

	Students who have studied insurance		Students who have had no insurance course		Total	
	Number	Percentage	Number	Percentage	No.	Percent.
Definitely Interested	22	23.4	19	13.4	41	17.4
Definitely Disinterested	22	23.4	43	30.3	65	27.5

The remaining students in each class are either only mildly interested or are undecided.

To facilitate quick comparison, a summary table of *interest in life insurance selling* follows:

	Students who have studied insurance		Students who have had no insurance course		Total	
	Number	Percentage	Number	Percentage	No.	Percent.
Definitely Interested	19	20.2	3	2.1	22	9.3
Definitely Disinterested	28	29.8	88	62.0	116	49.2

Why are students either undecided or disinterested in a sales career in insurance? The following are the reasons given by students in the University of Illinois College of Commerce. From these quotations, it can be seen that the insurance industry still has a big public relations job to do among college students:

1. Not interested in selling of any kind.
2. Selling insurance is dull, uninteresting, mechanical, stereotyped.
3. Want a decent salary, not an uncertain commission.
4. The job is too insecure and uncertain. Poor future—unsettled life.
5. Too many part time agents and uninformed agents who lower the prestige of the occupation and give it a bad name.
6. Requires super salesmanship which few people have.
7. Poor pay; there are much better selling jobs requiring selling direct to industrial and commercial establishments.
8. The market is a cut-throat market and it is unsteady and will soon break.
9. Companies indiscriminately hire too many agents, making it difficult for the career agent to make a decent living. Field is overcrowded.
10. Don't like to put up false front; don't like to entertain constantly; don't like to cater to customers; want to speak my own mind.
11. Don't believe in insurance myself and don't believe in selling

something I don't believe in. Insurance is not productive; it is not an essential service.

12. Don't like to sell intangibles; don't like personal selling.

13. In depressions everyone who can't find work sells life insurance; this lowers prestige of the job and makes competition unfair.

14. The field is full of failures at other jobs and "glorified flops."

15. Field is too static; not growing.

16. Salesmen don't need a college education—don't want to waste mine.

17. Hours are much too irregular; too much night work; time never your own; want to quit work at 5:00 p.m.; don't like working while others have leisure; not enough free time; too much time wasted waiting.

18. Lack of patience and despise the high pressure methods essential to the sale of life insurance.

19. Life insurance men are disliked; have pest complex; insurance men are resented; I hate insurance and insurance men; friends feel like they are obligated to buy from you.

20. Percentage of sales to calls too low.

21. Insurance selling is pavement pounding job; don't like door to door canvassing.

22. Too easy to get into, so the job has no prestige. Every Tom, Dick, and Harry sells insurance.

23. Not qualified, don't have the connections or knowledge.

24. Selling insurance is repulsive. I went to college so that I will not have to do repulsive work.

25. I like selling but not insurance. It is the least desirable type of selling.

26. Insurance companies defraud clients by enforcing clauses in fine print which restrict coverage. I would not like to deal with clients who feel that they have been cheated out of a claim which rightfully should have been paid.

Why are many of our students disinterested in positions in our home office or other non sales-jobs in insurance? The following reasons were given by a representative group of Illinois students.

1. Don't want inside job; don't like desk work.

2. Don't have the aptitude for clerical or routine work.

3. Compensation too low (not comparable with other lines); advancement too slow, future not bright.

4. Opportunities are limited; too few good jobs to be distributed to too many good men.

5. Full capabilities are not recognized or taken advantage of nor properly compensated. Insurance companies are notorious for underpaying.

6. The jobs are dull and require no initiative.

7. Don't know anything about it and have never thought about it.

Why are some of our students interested in insurance sales work? The following reasons are those given more often by University of Illinois students.

1. Opportunity to meet people.
2. Opportunity to be of service to people.
3. Pay is good with the sky as the limit.
4. Selling is appealing and insurance sales is interesting work.
5. The future looks good for insurance sales.
6. You do the buyer a good turn by making him buy.
7. The field offers a good deal of security in the renewal account.
8. Lively job which keeps one active in the community.
9. Selling a policy is a thrilling experience.
10. Selling intangibles is an interesting challenge.
11. Provides a good deal of free time. No clock to punch.

Some of our students prefer property-casualty insurance selling to life insurance because they say:

1. More sales are made in the business market rather than the so-called "consumer" market.
2. It carries more prestige than life insurance.
3. Can combine insurance with real estate and make a good living.
4. Not as competitive as life insurance.
5. Sales appeals are to reason, not to emotion as in life insurance.
6. Product is dynamic—more closely related to the needs of business.
7. Produces more variety than life insurance.
8. Job of educating the buyer not as great as the public already realizes the need of general insurance.
9. More repeat business. Once a life policy is sold—that is all.

Some of our students prefer life insurance selling to property and casualty insurance because they say:

1. Don't have to spend too much time servicing policies.
2. More specialized job.
3. More personalized selling—less order taking.
4. Don't have to deal with clients who are refused payment of claims.

The major reasons given by our students for their interest in home office or non selling positions are:

1. Insurance companies offer a variety of jobs of interest to different groups of students viz. personnel, financial management, adjusters, lawyers, engineers, accountants, actuaries, statistics, publicity and advertising.

2. Insurance is a fascinating business—an interesting field like it but don't have a sales personality.

3. Insurance companies are usually good companies to work for.

4. Insurance is a very vital business—a very stable business—providing its employees a steady income.

5. Insurance companies represent big business and provide unlimited opportunities.

In closing let me say that the major function of our universities is to turn out good citizens. We are financed out of public funds and we must turn out public minded citizens. In addition our colleges of commerce must turn out good businessmen—men who possess integrity, courage, knowledge of their business, and the desire and ability to become economic statesmen. We as insurance professors can help our students along all of these lines. We can help those students who wish to become insurance men by teaching them about the business they are preparing to enter, by placing emphasis upon the importance of courage and integrity and, finally, by explaining the importance of adhering to sound economic doctrine when they cast their votes. We must not insist upon too much of our student's time by loading them with insurance courses. To do so would be to deny them the full college education to which they are entitled. We want the students we turn out for employment in the insurance business to be educated both for good citizenship and good business — both for living and for making a living.

Discussion

by

Ben Sager, Central Mutual Agency, Cleveland Ohio

I must first ask that you consider my remarks in the light that I have been out of school for twenty years and that my contacts with the halls of learning have been few and far between in that period. Many of my thoughts are based on my recollections of what I did and saw in those carefree days when an education was the price one paid for the pleasures of campus and fraternity life. More recently have the educational problems of attaining a C.P.C.U. designation brought to my attention the dearth of insurance teaching facilities. Especially is this true for those who desire to make a career of insurance. With very few notable exceptions the colleges and universities today do not offer the opportunity for the young man or woman to prepare, beyond the historical phase, for a future in this important field in our economy.

Frankly, I personally lean toward the idea that a course in practical insurance should be given in one of two branches of the university structure.

It has no place in the liberal arts school. It should be a course in a business administration school or graduate school. As our law, medicine and other graduate schools now require preparatory work in undergraduate schools, so also should a practical course in general insurance.

Very few of our successful insurance men today, especially in the urban centers where competition is keen and mental gymnastics are required, have reached their present positions without a basic education. In their early educations the courses in economics, mathematics, English, business, law and history have proven their worth. However, their lack of training in practical insurance delayed their arrival at a successful point by many years.

I believe it is a fundamental purpose of our educational system to enable a man to achieve financial success at as early an age as possible. Therefore it follows that if he can be taught the practical side of insurance while still in school where such knowledge is easily assimilated, his later promotion should come more easily and quickly.

I would urge, therefore, that the colleges and universities establish an insurance department the same as they have for law, medicine, and the professions. I would intersperse the thought here that both of the agents associations are striving toward the goal that insurance will some day be a profession and recognized as such. Universities should therefore begin now to set up their courses of instruction in their graduate schools and encourage that program. It would be of immeasurable assistance to us in our program and would also react to the benefit of the universities by drawing students to them for this type of training.

Much ado has been made over the attainment by accountants of a C.P.A. designation. A man who holds these letters is acclaimed as an outstanding member of his community. Let us pause for a moment and compare him with the C.L.U. and C.P.C.U. in the importance of his contact with the public.

He is an acknowledged expert with figures. But after he has taken the figures you give him and dug out the additional facts he needs to make your ledgers balance, show your profit or loss, informed you as to the amount of your tax and made recommendations as to future problems of financing he is through. Consider on the other hand that the C.L.U. or C.P.C.U. must make decisions and advise you on problems which may affect your entire future and that of your children. The insurance agent of today must be educated and trained to the point that he can almost read your past, present, and future. An error in his judgment as to your insurance needs may cause you to lose everything you own, if an uninsured loss should occur. The public today is most peculiar as regards the insurance agent. He assumes his agent knows his business and relies upon him to see that coverage is as it should be. Policies are never read. If the colleges and universities will cooperate in setting up insurance courses, there is no reason why a C.L.U. or C.P.C.U. may not in the near future achieve professional rating and take the position in our economy he deserves. We have thousands of agents today who are all that they should be, but we have many more thousands who are not. It's time that the sheep and goats be separated and the agent who is qualified be recognized. Practical education of our future representatives is the only answer.

In addition to the graduate school courses, I believe there should be night school courses of an identical nature for those individuals who are unable to acquire the basic liberal arts education or desire to acquire their professional education while working during business hours.

The colleges with which I have been in contact have some courses in insurance. Those courses teach the theory and some of the historical background of the business. But when you get down to how to write comprehensive liability or contingent businss interruption insurance, you are up against a blank wall. Nowhere have I seen a course in fire rating, engineering or prevention outside of the Illinois Institute of Technology. Regardless of how successful a man may be in the insurance field, he cannot be said to be a professional man without a working knowledge of these fields.

It is not my purpose to outline a course of study. I believe Dean Loman and Dr. McCahan have already preceeded me in this regard with a well-thought-out program. What I desire to urge upon you is that you gentlemen in your institutions of learning start the program. It no doubt would have to start in a modest way, but I believe that any program designed to train students for the business of insurance would be cheered and supported by both companies and field forces. That this statement is true has already been proven by the response given when support was requested for The American Institute for Property and Liability Underwriters. Practically all of the companies and both the national associations of agents immediately responded with

lip service and funds. The National Association of Mutual Insurance Agents is planning an annual contribution so long as it is needed.

The Wharton School is known all over the nation for its business training facilities and a large percentage of their enrollment is in training for an insurance career. I know that if every state university would inaugurate an insurance course it would fill its enrollment in short order after the fact became known.

Some of our more progressive companies are trying to supply the need today by conducting home office courses for agents and their own employees.

Every year the companies comb the graduating classes for likely prospects to enter their training classes and go on in the insurance business.

Now it is the opinion of those with whom I have discussed this matter that a course in practical insurance is not an impossible idea. In various graduate schools we have laboratory work set up for the student. In law we have moot courts where the embryo attorney goes through the experience of drawing up briefs and trying cases. In medicine there are chemistry and physics labs where various types of analysis are gone through and then the medical student spends long hours with a cadaver so that when he actually has to open up a live body he knows what conditions he should find. Here he learns his medicine by actually coming in contact with the conditions he will meet in practice.

In mechanical schools programs have been worked out where students go to school to learn theory and then every 30 or 90 days they leave school to go into a factory to apply what they have learned. The combined theory and practice prepares them for their life work as no other method could do.

We believe that a combination of these proven methods could easily be worked out for insurance. Professors Loman and McCahan in their suggested course of study a year ago set forth the subjects they thought should be included in an insurance course. If these studies were conducted on a cooperative basis with insurance companies' branch offices and agencies you would coordinate the lab work something like this:

Accounting	Home Office Accounting Department
Commercial Law	Claim & Legal Departments
Organization & Management	Branch Office & Agency
Insurance Fundamentals	Underwriting Department
English & Letter Writing	Any Home Office Department
Public Speaking & Sales	Agency & Agency Department

We believe that any of our companies and many of our larger agencies and brokers would be glad to work out a program of cooperation. We also believe that the companies would guarantee jobs to a certain number of graduates on a two or three year basis after graduation. Such a program would solve their personnel problems and also take a load off of the placement officer in the university.

The objection has been raised that there isn't the opportunity for financial independence in the insurance business that other fields offer and therefore the colleges can't get their men to study for that field. I want to take issue with that feeling. I have been both a company

man and an agent and I have more than a casual picture of both branches of the business.

In the production end, the agent who knows his business, keeps up with current developments, thinks before he acts and then works at his business can make a very comfortable living. I know several agents who are financially independent today who had nothing when they started in the business. Strange as it may seem they never expected some one else to do their work nor were they always too busy to lend a helping hand to their fellow workers. They knew that their future lay in their own hands and that their income would be directly in proportion to their own efforts. They worked long hours making calls when it was very inconvenient and studying their manuals in odd moments. The work they did and the service they rendered has paid off and they are not looking forward to a meager livelihood on state old age pensions. The opportunity for a man who is willing to give the effort is just as great in the insurance business today as in any other field of endeavor.

While working as a company man it was rather interesting to note that the men who became department heads, officers and branch managers were likewise the men that worked. It is true that the job of a claim investigator, underwriter, field man, office clerk, etc., do not offer high wages. But these jobs are merely training posts for positions of greater responsibility and larger pay. When I graduated from law school in 1930 I was offered a job in a law office at $50.00 per month. I went to work as a claim investigator for an insurance company for $125.00 per month. Maybe if I had followed the law, I would be making more today. I don't know, but I doubt it. At least I have no regrets that I followed the path I chose at that time. The man who has it to give and will give it can get just as far in insurance as anywhere else.

It is also stated as an objection to the proposed action that the universities cannot find the teachers to give a full insurance course of training. Again I take issue. When the C.P.C.U. movement started there were no courses and no teachers to help those who wished to prepare for the examination. It was both startling and gratifying to see how men in the insurance industry came forward to *give* their time to help in what they felt was a worthy effort. Here in Cleveland we had at first an insurance professor. He is leaving us now but already we have three men—well qualified—who are taking over his work and their course is being given academic credit. In our own ranks we found a man who would and could teach accounting so that any of us could understand it. We also found qualified men to teach the business law and economics courses. What we did here is only a reflection of what happened in every urban community in the country. The insurance press is constantly reporting new C.P.C.U. study courses starting up.

When I was in law school we had two downtown lawyers come out and teach certain classes. What can be done in other fields can be done in the field of insurance. At the present time one Cleveland agent is teaching insurance at the University of Michigan. I know several qualified men who could be persuaded to teach at Cleveland Col-

lege or Reserve, Ohio State or the University of Cincinnati. I know others located near universities outside of the state.

The insurance industry and the men who give it life are interested in advancing the field of insurance, and if the universities indicate that they want to start such a course, they will have very little trouble in finding the men to help them make it a reality. Not only that, but I have more than a suspicion that some of the insurance companies might be persuaded to finance some chairs for professors of insurance and furnish scholarships. Don't sell the insurance industry short when it comes to encouraging study courses for employees or prospective employees. They know that the proper educational background will make their job of finding the qualified men for positions much easier. They are also looking for agents who know what the business is all about. Too often the good will a company has built up over the years, by means of an expensive program, is crushed to the ground by the innocent error of an unqualified representative. If the opportunity for an insurance education is available they will encourage its use.

I note that many of your members and a member of this panel are directors of insurance company training programs. That fact alone proves that the companies want well trained personnel and will spend money to get it. Imagine what they would do if the training program was taken over by the universities.

I urge you gentlemen to start the program at your institutions. Advise the insurance industry that you are starting it. They will see that you get the students that you need. Then they will take your finished product and give him the green light towards "possibilities unlimited." In the insurance industry the top rung for any man is that one to which his knowledge, ability, and willingness to work will take him.

Direct Sale of Security Issues

by

Harold G. Fraine, Professor of Commerce, The University of Wisconsin

During the past fifteen years an extraordinarily high proportion of the sales of new issues of securities has been characterized as privately placed. From the latest figures published by the Securities and Exchange Commission, it would appear that during the current year about forty per cent of all new corporate issues have been sold to one or a very few investors without public offering.[1] In only two of the years since the establishment of the SEC has the proportion of privately placed corporate bonds fallen below twenty per cent.[2] In one year the proportion was as high as forty-six per cent. (See Table 1.)

TABLE 1

Comparative volume of private & public placements of corporate bond issues.

Years Ended:	Private ($000,000)	Public
Dec. 31—		
1900-1933	1,027	35,585
June 30—		
1935	259	617
1936	409	3,504
1937	322	2,554
1938	357	685
1939	748	1,517
1940	748	1,343
1941	989	1,804
1942	523	1,164
1943	313	367
1944	585	740
1945	823	2,829
1946	1,160	4,206
1947	1,854	2,766

SOURCES: For 1900-1933, estimated from CORPORATE BOND STATISTICS: VOL. II, STATISTICS OF ISSUE & EXTINGUISHMENT, Table 19 (New York: Corporate Bond Study, a cooperative project under the direction of the National Bureau of Economic Research, 1941).
For 1935-47, Computed from THIRTEENTH ANNUAL REPORT OF THE SECURITIES & EXCHANGE COMMISSION (Washington: 1948, Appendix Table 3, Parts 2 and 4.)

1 Estimated from figures published in the November 1948 number of the STATISTICAL BULLETIN (Washington: Securities and Exchange Commission).

2 THIRTEENTH ANNUAL REPORT of the Securities and Exchange Commission.

Concern over this phenomenon has been expressed in many quarters of our society: in Congress, in legislatures, by text book writers, and by the supervisory authorities of our banks and insurance companies. Concern has been expressed over the problem of the corporations which issue securities, over the institutions which buy them, and over the investment bankers which are being by-passed. Most of the citizens of our nation are affected in some manner or degree: some, because they are holders or beneficiaries of life insurance policies; some, because they are stockholders of the corporations seeking capital; some, because they are bond salesmen; and some, because they are investors.

The time allotted to this paper is not sufficient to permit exhaustive treatment of the subject. But I should like to comment briefly on some of the causes of the high volume of such sales and on some of the problems which it raises.

The Securities Act as a Cause of Direct Sales

There seems to be a very wide-spread impression in the financial community that direct sales have existed only since 1933, the year in which the Securities Act was passed and that they are therefore a direct result of the requirements of that act.[3] This argument has a superficial attraction. As a matter of fact I try to use the same logic on my wife. It is an accepted fact that she is a much better cook than before she married me. But when I try to take credit for that development, she asks: "If the cat had kittens in the oven, would you have to call them bis-kits?"

The widespread impression that direct placements are largely due to the Securities Act seems to me to be based partly upon failure to consider certain facts and partly upon failure to take into consideration other and more probable causes. Of the factual defects, two of them are minor and one of considerable importance. One minor factual misconception is that private placements of securities did not take place before the passage of the Securities Act. (Table 1.) That impression may have come about because of dependence for knowledge upon the statistics of private placements published by the Secruities and Exchange Commission. These are unquestionably the most comprehensive statistics on the volume of such placements for recent years. But they purport to cover only the years since the establishment of the SEC. Data published by the Corporate Bond Study show,[4] however, that from 1933 on back as far as the series goes, which is 1900, there were only two years in which sales of entire issues were not found to have been made to a single institution or to so few as to permit their names to be listed in the financial manuals. The dollar volume of issues privately placed appears in several years to have been equal to more than one-tenth of the volume offered publicly and in one year to more than a fifth of that volume.

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3 Exemptions of direct placements from registration requirements are made in Sections 3 and 4 of Securities Act of 1933. See also RELEASES NOS. 603 AND 1862 of Securities and Exchange Commission.

4 See CORPORATE BOND STATISTICS, Vol. II—STATISTICS OF ISSUE AND EXTINGUISHMENT (New York: The Corporate Bond Study, a cooperative project under the management of the National Bureau of Economic Research, 1941).

The second minor empirical defect is that comparison of the statistics available before, with those available since the establishment of the Securities and Exchange Commission, probably overstates the actual increase in proportion of securities privately placed. The only known statistics for the years before 1933 were compiled by the Corporate Bond Study, which limited its population of issues to those described in the financial manuals. This limitation was necessary from a practical standpoint because the data were collected and classified long after the event of sale. On the other hand, since its establishment in 1934, the research staff of the Securities and Exchange Commission has asked each year the large financial institutions for information on their private placements and so has been able to expand its coverage to include many issues not mentioned in the public press. On the other hand the SEC classes as publicly offered, issues sold through competitive bidding or issues registered for sale through investment bankers, even though their distribution may actually have been confined to one or a few investors. As noted above the impressions that private placements did not take place before the Securities Act and that they may not have increased to the extent indicated on their face by available statistics are minor points. They have been commented upon here in passing mainly to help keep the record straight and to improve the accuracy of future statements on this subject.

It is possible that a much more serious misapprehension of the facts may have been made in assuming that the economy of the direct sale over the public offering is chiefly in the saving in the cost of registration under the Securities Act. This assumption may have been made because of knowledge that registration under the Act clearly has caused the issuers to make expenditures additional to those they would have made in the absence of the Act. The issuer is required for example to pay a fee for registration of a public offering with the SEC. This fee is found, however, to be much less than one one-hundredth of the total cost of flotation of almost any issue. More serious is the fact that printing costs are increased, because so much more information is required to be passed along to the prospective investors. It is also quite possible that fees to accountants and other experts are increased by reason of the Act requiring not only that the statements made be truthful and not misleading, but also that no material fact be omitted. However, the savings in these costs, by making a direct placement, constitute only a small fraction of the savings which would be made in other ways not related to the Act.

This is evident upon an analysis of the various costs of flotation disclosed in the registration statements for issues registered for public sale under the Securities Act. Compilations of these data by the Securities and Exchange Commission reveal that the major cost of public flotation is the commission for underwriting and distribution. Other expenses are minor in comparison and of course only a part of these can be attributed to the registation requirements. This is illustrated by the figures below[5] confined to bonds and preferred stocks issued in amounts between $1,000,000 and $5,000,000 in size of issue, because, of the number of securities known to be privately placed,

5 See Table 2.

the majority consists of these types and sizes. I have further limited the selection of statistics to those for issues underwritten. Had all issues registered for sale through investment bankers been included, the relative portion of flotation cost that could be attributed to registration requirements of the Securities Act would have been even smaller and the portion representing bankers' commissions even larger. Data for years 1938 to 1941 have been used, because 1941 was the last year for which the Commission seems to have published statistics in the detail necessary for this purpose. It may be observed that commissions for underwriting and distribution are much larger than the other expenses. Costs attributable to registration are but a fraction of the minor component of "other expenses".

TABLE 2

Cost of flotation of issues between $1,000,000 and $5,000,000 in size, registered under the Securities Act for sale to the public through investment bankers on an underwritten basis: broken down between

(1) compensation for underwriting and distribution and
(2) other expenses of flotation

	% of Gross Proceeds		
	Underwriting Distributing Commission	Other Flotation Expenses	Total Cost of Flotation
BONDS			
1938	2.4	1.5	3.9
1939	2.5	0.9	3.4
1940	2.8	1.2	4.0
1941	2.3	1.0	3.3
PREFERRED STOCK			
1938	4.5	0.9	5.4
1939	4.8	1.3	6.1
1940	5.2	0.9	6.1
1941	4.0	1.2	5.2

SOURCES: Publications by the Securities & Exchange Commission—COST OF FLOTATION FOR REGISTERED SECURITIES 1938-39 and STATISTICAL SERIES RELEASES NO. 572 and 715.

It is quite evident from these figures that as far as known costs of flotation are concerned, private placements are more likely to take place to save costs of public distribution that exist regardless of registration requirements than to save merely the relatively minor portion that can be attributed to the Securities Act.

It is quite possible that the issuers incur some cost incidental to the registration requirements that are not reported because they are not amenable to easy and accurate measurement. The time which the company's officers devote to conferences and study and the time the company's own bookkeepers, accountants, and staff members give to compiling information for the registration statement possibly result in giving less attention to other important but unrelated matters of the issuer's business. In the absence of statistics on this subject there is no way of knowing that such costs are more than would be involved

in public offerings in the absence of the Act, or more than would be involved in a direct placement.

When confronted with statistics on cost of flotation, advocates of the theory that cost of registration is the major reason for private placements have been known to take refuge in the statement that it is not the original registration cost but the cost of providing data throughout the life of the issue that is burdensome. This does not sound convincing, considering that the buyer on a direct sale also usually requires periodic reports. Furthermore, experts who have examined both material filed on public placements with the SEC and material filed on private placements with life insurance companies have expressed the opinion that the files on private placements are not inferior as respecting the quantity and pertinancy of information.

Finally there is of course the possibility that some direct sales are made to avoid the penalties that might accrue from violation of the Act on a public offering. No research has been offered in support of this or the other factors which we have been forced to classify as immeasurables. In the absence of such research the SEC statistics on cost of flotation constitute the only statistics bearing upon the effect of the Securities Act on private placements. As we have noted, these statistics seem to indicate that costs attributable to the registration requirements are small compared with those other costs of public distribution which would be avoided or reduced by private sale. If the savings through direct placement are mainly in the size of the investment bankers' commissions rather than in the cost of registration, why then did issuers by-pass investment bankers to a higher degree after 1933, the year in which the Securities Act was passed? The answer to this question is found, I believe in our consideration of the next factor.

Changes in Supply and Demand as Cause of Direct Sales

Probably much more fundamental than any of the factors already mentioned is the change in the supply and demand situation with respect to corporate bonds. To elaborate adequately upon that statement would require a paper in itself. Fortunately, in view of John Langum's talk at this convention tonight on insurance company investments and the capital market and the flow of excellent articles during the past couple of years from Harry Sauvain[6], Homer Jones[7], and others, there is no need of my attempting it. I should like, however, to bring to your attention a few facts which will at least serve to illustrate the point.

The year 1933 marked not only the passage of the Securities Act, but also certain changes in the relationship between the growth of the total supply of corporate securities and the growth in demand for such securities by the large financial institutions. It is now apparent that the Act was passed just after we had reached the peak in volume of long-term corporate debt outstanding. (See Table 3.) During the century up

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6 See, for example, "Some Economic Considerations Affecting Investment Policy", PROCEEDINGS OF THE AMERICAN LIFE CONVENTION, 1947.

7 "The Flow of Savings" and "Investment Prospects", THE JOURNAL OF FINANCE, October 1948 and April 1947 respectively; and "The Optimum Rate of Investment", (Proceedings of the American Economic Association, December 1947).

to that point, such debt had generally increased more than was necessary to take care of the investment needs of institutional investors. Reference to the Chart will show that the total amount outstanding of the long term bonds of the railroad, utility, and industrial corporations alone increased in an amount roughly equal to the increase in the total admitted assets of all life insurance companies. And such bonds are characteristically but a fraction of the whole investment portfolio of such institutions. Generally throughout that period the total supply of such media was evidently far in excess of the needs of both life insurance companies and banks.

TABLE 3

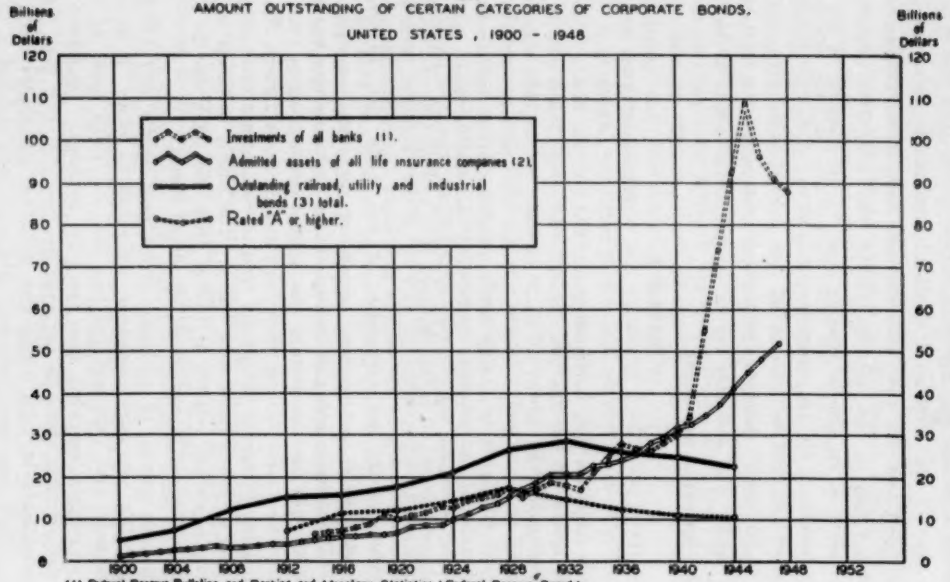
	Billions of $ on Jan. 1		
	1917	1931	1947
Long-term corporate debt outstanding	29.1	51.1	41.1
Admitted assets, all life ins. cos.	5.5	18.9	48.2
Total investments, all banks	6.6	18.1	96.1

SOURCES: Long-term corporate debt outstanding—Department of Commerce estimates as published in 1948 WORLD ALMANAC.
Admitted assets, all life ins. cos.—SPECTATOR, Nov. 1948, p. 18.
Total investments, all banks—Bulletin, Nov. 1948, p. 1384 and BANKING & MONETARY STATISTICS, p. 18 (Bd. of Gov. Fed. Res. System).

Beginning with the depression of the early 30's, however, a reversal took place in the total supply of corporate securities. By 1944 the volume outstanding of railroad, utility and corporate bonds was about twenty per cent lower than the amount outstanding in 1932. The contraction was more serious than indicated by these figures, for both banks and life insurance companies tend to concentrate their corporate investments in bonds rated A or better. The supply of bonds so rated underwent a greater relative shrinkage than the total, due to almost wholesale reductions in ratings on individual issues.

While the supply of corporate investment media was shrinking, banks and life insurance companies continued to grow. It is of interest to note that 1933 was the last year in which loans of banks in the aggregate exceeded their security holdings. Long-term corporate debt shrunk about 20 per cent between 1931 and 1947, but the total investments of both banks and insurance companies more than doubled. While long-term corporate debt was being reduced in amount by approximately ten billion dollars, the investments of banks and the total admitted assets of life insurance companies together increased by more than a hundred billion dollars. These divergent trends are especially important when it is considered that such institutions like to maintain a balance within their portfolios among different types of investment media. In spite of the fluctuations in supply, life insurance companies in the aggregate succeeded in holding the proportion of corporate bonds to between a fourth and a third of their total admitted assets during all of the past 28 years. (See Table 4) Thus the phenominal growth of banks and life insurance companies during the past decade and a half has tended to increase their

GROWTH OF INVESTMENTS OF BANKS AND OF LIFE INSURANCE COMPANIES
and
AMOUNT OUTSTANDING OF CERTAIN CATEGORIES OF CORPORATE BONDS,
UNITED STATES, 1900 - 1948



(1) Federal Reserve Bulletins and Banking and Monetary Statistics (Federal Reserve Board).
(2) Spectator, November, 1948.
(3) Preliminary estimates by the Corporate Bond Research Project of the National Bureau of Economic Research, under the direction of W. Braddock Hickman.

appetites for corporate bonds.[8] The fact that the supply of such bonds has actually declined has tended to make their hunger even greater.

TABLE 4

Percentage corporate bond holdings of all admitted assets, all life insurance companies

1920	28.3	::	1927	28.7	::	1934	24.8	::	1941	31.1
1921	26.4	::	1928	28.7	::	1935	24.8	::	1942	29.3
1922	26.4	::	1929	27.4	::	1936	25.7	::	1943	27.3
1923	26.3	::	1930	27.4	::	1937	27.1	::	1944	25.1
1924	27.2	::	1931	26.5	::	1938	28.3	::	1945	22.9
1925	27.5	::	1932	25.4	::	1939	28.9	::	1946	25.3
1926	28.0	::	1933	24.9	::	1940	29.9	::	1947	29.5

SOURCE: Computed from Tables 1 & 1A of Bruce E. Shepherd's monograph, THE LIFE INSURANCE RECORD FOR 1947, (New York: Life Insurance Ass'n. of America).

We can now see why a change since the early 30's took place in the portion of bonds publicly and privately placed. Before that the flow of corporate securities tended to be far in excess of the requirements of the large investing institutions. Consequently, issuers in general were forced to sell their securities through a mechanism that would reach smaller investors. The investment banker had to be depended upon to furnish this mechanism. In the late 30's and in the 40's however, the financial appetites of the large institutions alone were far in excess of the flow of corporate bonds to market. Issuers no longer needed wide distribution to sell those of their securities which were of the character needed by the large investing institutions.

My belief is that the rise in proportion of private placements has resulted chiefly from a change in the relationship between the demand for and supply of corporate bonds and would have come about whether or not there had been passage of the Securities Act.

Problems of the Investment Banker Raised by Direct Sales

Turning to some of the problems raised by the increase in direct sales, let us first consider the investment banker. Certain questions immediately come to mind: on the issues in which the terms have been settled by direct negotiation between the issuer and the buyer, has the investment banker been by-passed completely or only partially? Which of his activities has been most affected? The financial community is indebted to the investment banker for three types of service:

(1) serving as original contact between the issuer and the investor; (2) advising the issuer on terms; and (3) employing a large force of salesmen to give securities a wide distribution among investors.

Research on the extent to which the investment banker has exercised his first two functions on directly placed issues might prove very

8 The writer is indebted to Haughton Bell, Assistant General Counsel of the Mutual Life Insurance Co. of New York, for the reminder that demand for corporate securities by life insurance companies increased also due to liberalization of state laws governing investment. See his discussion of this paper.

interesting. I suspect the results would be surprising to most people. Mr. Stuart Silloway, Vice-President of the Mutual Life Insurance Company of New York, in a speech two months ago said that of the directly negotiated issues considered by his company about two-thirds were brought to their attention by investment bankers.[9] There is reason to believe that his company's experience is not atypical, and that in such case the investment banker also advises the issuer with regard to terms and covenants. Thus in many direct placements the investment banker is still rendering two of the valuable services mentioned above and is entitled to, and receives, compensation for performing them. There do not seem to be available published statistics showing the rates of commissions on direct placements. My recollection from individual cases is that they are most frequently about one-quarter of one per cent of gross proceeds. Thus, the percentage of gross proceeds paid to the investment banker on a typical direct placement is very small compared with his commission on a public distribution. This is understandable when it is considered that fees to investment bankers on public distributions tend to vary according to the risk involved. To illustrate, for securities registered with the Securities and Exchange Commission for sale to the general public through investment bankers in 1947, such fees amounted to the following percentages of the gross proceeds: (See Table 5) The same trend of variation of compensation with risk is apparent among the various grades of bonds. Although an investment banker may be performing some services in connection with a private placement, he is not risking his capital his credit, or his reputation, and he has no need to employ salesmen. The smallness of his commission on private placements is a reflection of these facts.

TABLE 5

Investment bankers' commissions on securities registered for sale through them to the general public during the fiscal year ended June 30, 1947 arranged according to type and grade of security

	Commission in % of gross proceeds
Bonds	.9
First grade	.6
Second grade	.5
Third grade	.9
Fourth grade	1.4
Fifth grade	1.4
Below fifth	4.3
Preferred Stocks	2.8
Common Stocks	9.3

SOURCE: THIRTEENTH ANNUAL REPORT OF THE SECURITIES & EXCHANGE COMMISSION, Appendix Table 2.

Does the practice of direct negotiation between issuer and investor threaten to cause the death of the distributive function of the investment banker? We have seen that on such placements he receives no

9 An address to the annual convention of the Commercial Finance Industry on October 25, 1948.

fee for the unneeded salesmen. We have also seen that there has been substantial upward trend in the proportion sold privately of all issues sold. The consequent decline in the proportion of issues publicly distributed has been accompanied by another aggravating factor. This is the decline in recent years in the average rate of commission received on issues publicly distributed. Proper test of this point requires reference to securities of comparable grade. Examination of the rates for bonds of each grade published by the SEC in its annual reports confirms this statement. Let us take for illustration bonds of the fourth grade, corresponding to the ratings of "Baa" by Moody and "Bl plus" by Standard and Poor's. The percentage of gross proceeds paid to investment bankers on such issues has moved as shown in Table 6.

TABLE 6

Decline in recent years of investment bankers' average commission of fourth-grade corporate bonds registered for public sale under the Securities Act (expressed in percentages of gross proceeds)

1939	2.3
1941	2.0
1943	2.0
1945	1.5
1947	1.4

SOURCE: Appendix tables in recent annual reports of the Securities & Exchange Commission.

Have any steps been taken to prevent the bypassing of the distributive function of the investment banker? Valient efforts have been made to make direct placements more difficult. A substantial proportion of the 1,544 pages of the report of the hearings held by the House Committee on Interstate and Foreign Commerce from November 1941 to January 1942 is given over to efforts to secure revision of the Securities Act of 1933 in such a manner as to require the registration of privately placed issues. These efforts ended in a flat failure. Possibly this was because Congress was principally concerned over the small and unsophisticated investor and the belief that the institutional investor did not need protection by the Securities Act. Possibly it was because cost of registration was stressed unduly as a cause of direct placements, when it appeared to be minor compared with other costs of public distribution, including the commissions for underwriting and distribution. Possibly the efforts failed because evidence was introduced to show that there were cases where issues which had been registered for distribution to the public through investment bankers and had carried commission commensurate with that purpose but which had in fact been sold in entirety by investment bankers to a few institutional investors.

Hearings were also held by a Joint Committee on Insurance Rates and Regulation of the New York Legislature only last month (Nov. 22, 1948) in which questions were raised as to the wisdom and propriety of the practice by insurance companies of bypassing the investment banker in negotiations on security purchases.

Investment bankers are far from alone in being concerned over

the future of their distributive function. Concern has been expressed in almost all branches of the financial community over the possibility that the low volume of publicly offered issues will prevent the maintenance of a sales force which may be sorely needed at some point in the future to service a high volume of corporate issues and to restore a flow of securities to small investors. There still seems to be life in the idea that by prohibiting, making more difficult, or more expensive the practice of direct sales, more securities will be sold through securities salesmen and more will be sold to small investors.

Before trying to achieve that end by such means it should be appreciated that it would constitute in effect a subsidy of one part of the financial community by another. The subsidy would be borne, at least partly, by life insurance policy holders through lower dividends and therefore through higher net premiums . It might also result in a lower volume of corporate financing, not merely because of higher costs of flotation, but also because many corporate issues privately placed may not have the characteristics necessary for a widespread distribution. This is suggested by the fact that a majority of the number of the issues privately placed have been less than $5,000,000 in size of issue.

The possibility should be recognized that the subsidy might turn out to be abortive. This might well be the case if new issues generally were forced to bear the cost of wide distribution and investment bankers found it necessary, because of an insufficient number of small investors, to sell after all the same proportion of new issues to large institutions. We need to know more about the dissaving in corporate bonds which has recently taken place by individual investors. Has it been entirely involuntary: that is, brought about by calling for redemption issues held widely and refunding by private placements? Or has it been largely due to factors which appear relatively permanent, such as: high inheritance taxes; progressive, and increasing rates of, income taxes; increased interest in life insurance protection; low level of interest rates? It is to be hoped that a comprehensive study of savings and their relation to the capital market now being made by Dr. Raymond W. Goldsmith under a research grant from the life insurance companies will shed light on this problem.

Problems of Issuers Raised by Direct Sales

The willingness and ability of investing institutions to negotiate directly also raises problems for the issuer of securities. These problems would appear, however, to be rather pleasant ones. And, in contrast with the more dependent position of the investment banker, the issuer is in a position to do something about his problems. To the extent that his securities lack the characteristics for public distribution, private placements open to him an alternative source of capital that might not otherwise exist. To the extent that his securities are qualified for both the institutional and public market, he is in the happy position of taking his choice of the two alternatives. Therein lies his principal problem, which is to weigh the advantages and disadvantages of each method and decide in the light of his own circumstances whether private or public sale more nearly meets his particular needs.

Among the possible disadvantages of the method of direct sale,

the issuer may consider the following. (1) He would forego the more widespread knowledge of, and interest in, his corporation that tends to accrue from public distribution. Such knowledge and wide interest might be important to his gross income in the same sense as other advertising. But more certainly he would know that public familiarity with his financial performance might be of value should his corporation at some time in the future find it necessary to appeal to the public market for accommodation.

(2) Securities of an issue which is placed privately could probably be obtained for sinking fund purposes only by call at par or at a premium over par. On the other hand securities publicly placed might often be picked up in the open market at a discount from call price if the issue were widely distributed and also had the size and other characteristics necessary for a fairly active market.

(3) The purchaser of an issue directly placed might insist upon a stronger sinking fund provision or more stringent protective provisions than the investment banker.

(4) Finally, he might consider it wise to sell through the investment banker in order to help support a distributive mechanism that would be needed in the event that the total supply of corporate media again exceeds the needs of the investment institutions.

Against the drawbacks he might well consider a number of possible advantages of direct sale. (1) Perhaps the most important of these is the fact that there is less cost involved in a private sale than in a public distribution and he could negotiate for terms which would give him a share of the saving. Such savings would tend to be especially high on small issues. For example, in 1947 the percentage of gross proceeds paid to investment bankers on bond issues registered under the Securities Act for public distribution varied as follows with the size of issue:[10]

TABLE 7

Variation of investment bankers' commission with size of bond issues registered for public sale in year ended June 30, 1947

(commission in % of gross proceeds)

Size of issue (000,000$)	Commission
50 and over	.6
20 — 50	1.0
5 — 20	1.1
1 — 5	2.1
Under 1	5.0

(2) In the event of inability to meet one of the contractual provisions it is quite probable that the issuer could secure a modification more quickly and easily if the issue were privately placed than publicly distributed. Most publicly distributed corporate bonds are not registered. Title usually passes from one owner to another merely by passing the bond. The holders collect income by clipping coupons and cashing them

10 Thirteenth Annual Report of the Securities and Exchange Commission, p. 150.

through the banking system. Advertisements in the public press might be necessary in order to bring the problem to the attention of the holders. The more widespread the distribution, the more difficult it would be to arrange agreement among the many holders interested, and the more widespread might be the advertising of the corporation's financial embarrassment. On the other hand negotiations for modification of terms with the few holders of an issue directly placed could be started quickly, and without fanfare. The smallness of their numbers and their sophistication in financial matters would be likely to result in quick agreement upon a just and necessary modification. Furthermore the fact that the buyer had a voice in setting the terms in question would tend to give him more of a feeling of responsibility toward adjusting them than might be the case of a holder who had not been consulted originally.

(3) Another advantage to the issuer of a direct placement might accrue in the event that either the money market or the issuer's credit standing changed in a direction which would permit the issuer to refinance at a more favorable rate of interest. If the issue had been widely distributed this could probably be arranged only through calling the entire issue for redemption and the refunding issue would have to return to the public through the investment banking mechanism with a repetition of all of the costs of public flotation, including registration, engraving of bonds, printing of prospectuses, and the employment of salesmen. There is a probability that had the issue been privately placed it would only have been necessary to convince the investing institution of the ability to call and refinance publicly in order to secure an adjustment of the contract upon terms that would save the issuer much of the expense of the public refunding.

(4) Finally the issuer may prefer a direct sale because a public distribution may undergo delays due to market uncertainties, and its success when attempted depends largely upon stability of the market. The terms set by the institutional investor are usually with the view of holding the issue for its entire life with little regard for market fluctuations. The investment banker, on the other hand, expects to hold the issue as short a time as possible, and his terms are set with only the near term market in view. The divergent effects of their differences in outlook are illustrated by two sentences in last month's issue of the New York Federal Reserve Bank's *Monthly Review of Credit and Business Conditions*: ". . . as the result of the fall in bond prices, the market quotations of many new securities subsequently fell below the issue prices and this did tend to act as a deterrent to the public sale of new bonds. Private sales to insurance companies and other institutions, ungoverned by immediate price developments, remained large, representing about two-fifths of all new corporate issues in the ten months ended with October."

Problems of Buyers of Directly Placed Securities

When we turn to consider the problems of the buyers of privately placed securities, we are faced with the fact that only a large scale investor could possibly absorb entire issues or substantial parts of issues and still have adequate diversification of the portfolio. Few individuals have portfolios running into hundreds of millions of dollars.

Therefore our attention can be limited to the large financial institutions. The investment operations of these institutions are limited by law and regulated by public authorities. Therefore we shall consider problems originating in their regulation as well as in their operations.

Banks, with investment holdings in excess of 85 billion dollars, constitute the largest single investing group. These are mostly commercial banks, but the total includes holdings in excess of 13 billion dollars by mutual savings banks. Trust departments and trust companies are estimated to hold about 50 billion dollars of securities, but most of the individual trusts would be too small to absorb direct placements in important volume. Of most importance are the life insurance companies with assets well in excess of 50 billion dollars.

Direct placements impose little in the way of new operating problems for banks and life insurance companies. The same men who analyze the terms, protective provisions, and financial background of a publicly distributed issue and decide whether to accept it at a given price can as well decide at what price and with what provisions a directly offered issue is acceptable. Thus there is nothing essentially unique in the buyer's interest in the price and other terms in a direct sale.

Issues bought directly from the issuer impose somewhat of an operating problem in connection with their characteristic lack of marketability. As long as such an issue is held in only a few hands there will not be market quotations nor an active market in the usual sense of the word. In this respect they differ from issues bought from intermediaries only in degree. Many issues sold publicly lack a ready market. When buying any issue not highly marketable, whether it was bought directly or indirectly, the investment officer must of course consider the extent to which his portfolio needs ready liquidation. He will doubtless consider the extent to which the maturity distribution fails to coincide with the predictable cash drains and the extent to which the actual cash drains may possibly vary from the expectations. Banks, with so much of their liabilities in demand deposits and with little basis upon which to predict closely the year to year changes in business conditions and the consequent demands on cash, generally find it advisable to keep a high proportion of their portfolios in highly marketable securities. Life insurance companies, on the other hand, with a better actuarial basis for predicting their future cash needs can afford to hold a much smaller proportion of their portfolios in highly marketable securities. They are thus able to count upon holding a higher proportion of their securities from the date of original purchase to the date of final redemption. In this respect, directly placed issues can be absorbed safely to a greater extent by life insurance companies than by banks.

The problems faced by the supervisory authorities as the result of direct sales of securities are found to relate mainly to (a) the question of whether to put special restrictions on the practice of direct negotiations or (b) the question of how to value privately placed securities in the absence of current market quotations.

Up to 1938 it appeared that national banks could invest only in

marketable securities.[11] But in that year the Comptroller of the Currency interpreted the Federal Statute in such a way as to open the door to bank investment in directly placed issues of bonds.[12] Insurance companies had for some time been permitted to invest in that manner and the propriety of their continuing to do so has been covered so well by Sherwin C. Badger in his address of October 4, 1948, before the Finanicial Section of the American Life Convention that I am going to confine my concluding remarks to a few observations on the other supervisory problem of valuation.

With regard to valuation, there is the problem of whether to (1) value privately placed like actively quoted securities—that is, assign values where there are none; or (2) ignore market quotations for both quoted and unquoted securities; or (3) make some compromise between the market and cost bases. All three of these treatments are found among the three large investing institutions: commercial banks, mutual savings banks, and life insurance companies.

National banks have been allowed to carry investments on their balance sheets at cost, less write-off of any premium. But up until 1938 the examiners had been allowed to deduct depreciation to current market quotations on bond holdings in making their own estimates of "net sound capital" of banks in their examination reports. In 1938 all of the federal bank supervisory authorities agreed upon a revision in the examination procedure by which the examiner is limited in effect to recording only a small fraction of market depreciation on such issues not in default.[13]

A few years later the Federal Deposit Insurance Corporation revised the valuation requirements for insured mutual savings banks in such a way as to require no reference to market quotations in the valuation of any bond not in default. Valuation reserves were, however, required to be accumulated according to the degree of risk of the investment ultimately paying out.[14]

Life insurance companies are required in the valuation of their securities to give greater consideration to the flucuations of market prices throughout their period of holding than are either banks or mutual savings banks.[15] Complete write-down to the current market quotation when it is less than cost is required of an insurance company for a bond holding which has fallen in rating below the fourth highest grade, whereas a national bank is only vulnerable to recognition in the examiner's report of a small fraction of the depreciation of market from cost. One serious drawback to the life insurance requirement is

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11 See paragraph Seventh of Section 5136 of Revised Federal Statutes (12 U.S.C. 24).

12 See paragraph 100 of DIGEST OF OPINIONS OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY RELATING TO OPERATIONS AND POWERS OF NATIONAL BANKS.

13 FEDERAL RESERVE BULLETIN, July 1938, pp. 563-65.

14 ANNUAL REPORT OF THE FEDERAL DEPOSIT INSURANCE CORPORATION FOR 1946, pp. 71-77.

15 For valuation requirements of life insurance companies, see introduction to LIST OF SECURITIES HELD BY LIFE INSURANCE COMPANIES (January 25, 1948: National Association of Insurance Commissioners Committee on Valuation of Securities).

that it would tend to tempt companies to dump marketable securities during a depression, when both ratings and market quotations are falling, in order to avoid the impairment of their surplus accounts which would come from further declines in these two variables. This temptation would not be confined to the bonds rated lower than Baa, but would apply to those in the A and Baa groups as well. For in the last depression a high proportion of corporate bonds had their ratings cut more than one step.

The valuation requirements also tend to discourage new investment in the borderline class—the fourth highest rating group. This seems unfortunate considering the past record of this class. Statistics have not yet been published by the Corporate Bond Research Project of the National Bureau of Economic Research. But from facts so far available it would not be surprising if that research, currently under the able direction of Dr. W. Braddock Hickman, eventually showed that this class of bonds has had generally as good an average net realized yield performance as the aggregate of the higher rated bonds.[16] Finally, it is quite conceivable that subjecting life insurance companies to the penalty of market fluctuations on quoted and rated bonds might tempt them to prefer directly placed issues because of the absence of ratings and quotations on such issues.

The existing valuation requirements not only constitute a threat to the stability of the bond market in a time of depression but they also impose an almost insuperable job on the life insurance commissioners. According to their own regulations they would in effect have the responsibility of analyzing the credit risk of each private placement and, for those adjudged to be not comparable in quality with bonds rated Baa or better by the rating services, of deciding what their market values would be if they had active markets. According to press reports of testimony in the hearings held last month by the New York legislature, the current investment of somewhere between $6,000,000,000 and $10,000,000,000 by life insurance companies in privately placed securities is spread over more than 2,000 different different issues. In addition to these there are doubtless many securities held from public placement on which market quotations are not available. Attempts by life insurance commissioners to rate and value such securties would appear to be a very costly job. It would involve doing each year what the life insurance company analysts did thoroughly before making their original commitments. To do it properly and so frequently could conceivably require duplication of at least a substantial part of the analytical facilities of the business. Policy holders would probably have to pay the cost.

What is the solution? It seems to me to lie in following the example set by the federal supervisory authorities of the insured mutual savings banks in moving completely away from the use of market quotations and ratings in the valuation of fixed income securities not in default. Such a move might have a number of good effects. It could remove

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16 In the meantime, see H. G. Fraine, "The Corporate Bond Research Project", PROCEEDINGS OF THE AMERICAN LIFE CONVENNTION 1947, especially pp. 431-2, for some preliminary findings.

the incentive to invest in privately placed securities in order to avoid the penalties accruable from a decline in ratings and market quotations. It could remove the temptation to dump securities in a depression. It could remove certain inconsistencies in the present valuation requirements.[17] It would also make the valuation of privately placed bonds consistent with the valuation of mortgages. It would be more consistent with the fact that life insurance companies tend to hold securities over their whole lives to a greater extent than commercial banks and mutual savings banks and are less dependent in their investment decisions on intermediate market quotations.

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17 For example: of privately placed preferred stocks, the higher grade are more vulnerable to a write-down than are the medium grade; whereas of privately placed bonds, only those substandard in grade are vulnerable to such write-down.

Discussion

by

A. N. Guertin, Actuary, American Life Convention

So much has been written and said about the direct sale of securities, or to use the term "private placements" common in the life insurance business, that Dr. Fraine is to be congratulated on bringing to us points which are new. His association until recently with our business adds to his background something which suggests that his remarks should be regarded as additionally significant by those whose business it is to invest funds for life insurance companies and those who are interested in supervising their operations. I read his paper with great interest and regard it as a valuable contribution to the literature on the subject.

Do not let me sail under false colors before this audience. I am not an investment expert. I have never invested insurance company funds. I do not propose to pass on the investment quality of private purchases. But as one who has spent his entire business lifetime in and about insurance companies, and who is interested in them as the institution that serves, to the highest degree, the urge of the individual to carry out his own obligations by the old-fashioned method known as thrift, I have dared to accept your inviation to discuss this paper which deals with a subject usually regarded as outside the field of my activities.

Under such circumstances, therefore, you must understand that I appear here neither as the representative of the life insurance business nor of any company, not even as a policyholder, although I hasten to add that my dimensions as a policyholder are much larger than my dimensions as a capitalist. My only excuse is that, as a student of life insurance, I am interested in all their activities and circumstances and, to the extent that private purchases of securities constitute one of the activities of life insurance companies, I am interested in that.

One of the most significant points made by Dr. Fraine, in my opinion, is pointing out that private placements were not new in our economic system, that for many years, even before the establishment of the Securities and Exchange Commission, such sales had been consummated in considerable volume, although the relative volume has increased greatly in recent years. This would seem to suggest that the present volume of such sales may be the result of economic conditions rather than the mere avoidance of certain mechanisms which are regarded by some as unduly cumbersome and expensive when applied to some types of transactions. Possibly, also, the growth of the assets of the life insurance companies, thus placing them in a position to purchase securities in larger blocks without loss of diversification, may have given impetus to such transactions more than some of us have realized. If it is a normal development of investment procedure, there may be little reason for concern that has been manifested in some quarters over the extent of the development.

Reference is made in Dr. Fraine's paper to the recent hearings held by the Mahoney Committee of the New York Legislature, at which testimony was given by the presidents of the four largest life insurance companies. In answer to the question "Should private loans or placements be limited as to amount or percent?", all were unanimous in the opinion that limitations, if any, should be applied to the *kind* of securities and not to the *manner* of acquiring them. Probably, an excerpt from the testimony of Mr. Leroy Lincoln, President of the Metropolitan Life Insurance Company, with regard to any such limitation might be regarded as typical of the attitude of the companies which have made such investments in large volume.

"There is no fundamental difference between investments acquired by an insurance company through private placements and those acquired through public purchase. Private placements have become an accepted, simple form of financing, advantageous to both the borrower and the lender and do not affect adversely the public interest. The making of private placements is not limited to insurance companies, but is open to other institutions and funds with money to invest. If restrictions are placed upon life insurance companies the result is that they will be placed in a straight-jacket when seeking investments while they competitors will be free to act as they may deem advisable. Furthermore, there is no more reason for attempting to force borrowers to raise their funds publicly through the investment banking fraternity than there is to require borrowers desiring bank credit to negotiate the loan through an intermediary who would then choose the bank which would extend the credit. Private placements represent one means by which investments may be acquired, just as purchase of a public offering is another means. The inherent character and quality of the investment should not be confused with the method of acquisition."

As to the function of the investment banker in private placements, Dr. Fraine indicates just how he fits into the negotiation and points out that, in the case of one large life company, two thirds of the issues bought were obtained through reference by investment bankers. In his testimony, before the Mahoney Committee, Mr. Thomas I. Parkinson, President of the Equitable Life Insurance Company, indicated that in the case of his company, also, most of the private placements now come through banking houses and brokers. If this is true of other investors, and there is no reason to believe that it is not, it would seem to me that here is a clear case of the opportunity of the investment bankers to develop whatever advantages would accrue to the issuer from a public issue. It would seem to make for proper competitive opportunity with decision in the hands of the issuer.

There are numerous questions in the paper which I am disposed to leave for the discussion of others. Certainly, I am in no position to take exception to or approve the statistical data developed on the relative costs of a private placement as against the flotation of a public offering. I am in no position to discuss the effect of the growth of private placements on the standing in the financial community of the investment banker, nor the effect on the supply of investments generally available to the smaller investor of large direct placements. These are

questions which I must leave to the economists and to the investment bankers. There are, however, a few problems discussed in the paper that suggest themselves as suitable for the advancement of observations.

Life insurance companies would appear to be naturals for the acquisition of such securities. They are able to consolidate the small savings of the many in investable funds of large proportions. Their obligations are not immediate cash obligations. Actuarial processes can determine, in advance, within relatively narrow margins, the demands for cash year by year which are likely to arise from a given volume of business in force. Investments can be correlated to those demands by staggering maturities and fixing amoritization of debt investments so that only in exceptional circumstances would it ever be necessary to liquidate investments to provide cash. If this principle is generally followed, life companies become buyers but not sellers of securities. They bcome buyers of securities from the standpoint of income yield and security of interest and principal. In this respect they differ substantially from financial institutions whose assets must be in a constant fluid state and, from an investment standpoint, therefore, they should probably be less concerned with market value quotations than most other financial institutions.

This preamble merely leads up to, but does not solve, the most important operating problem relative to these securities that faces the life insurance companies. The standards of valuation applied by the State supervising authorities, ordinarily applied to quoted securities, are very difficult of application to private purchases. Dr. Fraine points out the problem and refers to the paper read before the Financial Section of the American Life Convention this Fall, by Mr. Sherwin C. Badger. The problem is discussed there in somewhat greater detail. The importance of the problem springs not so much from the intrisic value of such securities as from the inability of life insurance companies, due to their characteristic modest surpluses, to absorb wide swings in the values of their asset portfolios.

This in itself, aside from legal restrictions, is a strong incentive to conservative investment in debt instruments of a quality which will make them eligible for valuation on an amortization basis not only currently but as far in the future as judgment can anticipate. Bonds acquired through private placement must meet this test just as well as bonds acquired through the regular investment channels and on which quotations are available.

As all of you know, amply secured bonds are deemed amortizable under most state statutes and amortized values are generally used in the Annual Statements of life insurance companies. The standards for "ample security" are defined by the National Association of Insurance Commissioners in terms of ratings by statistical organizations or yields based on current market. Both of these are lacking in the case of private purchases. Up to the present time, study of data relating to specific issues by a sub-committee of the Committee on Valuation of Securities has replaced the measures based on ratings and market values. The almost uniform high quality of privately purchased securities held by life companies, however, has made this task not too difficult.

The possibility, however, that some day economic conditions might

change to such an extent that current methods would require determination of market values for private placements has given the Commissioners' Committee some concern. Considerable study has been given to the problem, not only by the Committee itself but by the New York Insurance Department working with the Committee. In this connection, also, all segments of the insurance businss have associated themselves through a committee among whose problems this one is of top importance. That some formula for the valuation of these securities will be found is highly desirable. That the formula will be a sound and practical one is the hope of both company executives and supervisory officials.

Possibly the basis of valuation for all securities is entitled to review as well as merely consideration of private purchases and, in that review, possibly the basis of a method for valuation of the latter would evolve as a natural consequence. It is a fascinating problem and one to which the intelligence and energy of inquiring persons might well be turned.

Just what possibilities offer themselves for solution of the problem of valuation of private placements have not been the subject of very broad public discussion. Can a method be found which can be correlated to the method used in the case of quoted issues? Will it be necessary to review the present valuation formulae in the light of the need for a valuation formula for private placements? Must there be devised some procedure for private placements apart from that presently used for quoted securities? Should any valuation formula applicable to insurance companies continue to be tied more closely to current quoted market values than those applicable to other financial institutions whose need for liquidity would seem more important? These are broad questions, the answers to which must be found.

Dr. Fraine points out the anomaly which exists between the method of valuation used in the case of banks as contrasted with insurance companies. It may be interesting to draw a parallel in schematic form in the case of bonds.

Rated	*Banks*	*Insurance Companies*
Baa and higher	Amortized value	Amortized
Ba and lower	Mean of book value and average market value over eighteen months	Market value
Defaulted	Market value	Market value

It will be seen that the valuation method applicable to insurance companies is decidedly more severe in the sense that market values must be more closely followed in the case of insurance companies than in the case of banks, even though, as indicated before, the problem of liquidity in the case of life insurance companies is certainly less important than in the case of banks.

It may be of interest to review, for a moment, the present formula and how it is applied to private placements. As I have indicated, "amply secured" corporate bonds are permitted to be carried at amortized values. Other bonds must be valued at market quotations. It

follows, since "ample security" is determined on the basis of current market or market ratings, that there is no similar criterion in the case of private placements.

Each year a sub-committee of the Committee on Valuations of the National Association of Insurance Commissioners requires holders of private placements to submit to them full data with respect to the financial situation of the issuer, as well as copies of the indenture and other documents having a bearing on the security of the issue. On the basis of this data, a decision is made as to the "security" of the issue. If the issue is at least as well secured as quoted securities qualifying for amortization, it is deemed "amply secured" and authorized for amortization. If it is found not as well secured as amortizable quoted securities, or if it is in default, it is deemed "not amply secured" and becomes subject to being carried at market value.

But what is market value in the case of a security which is not traded? Is there sufficient machinery and data available, not only with respect to the particular issue but with respect to general market conditions and similar quoted issues, for any individual or group of individuals to sit down and, on the basis of that data, assign arbitrarily a market value to the particular issue? Would it be better to attempt an analysis of the whole market and apply specific charge-offs over some designated period to bring the value down to some sort of average price based on a broad selection of non-amortizable or defaulted bonds, as the case may be? These are merely random thoughts of one who sees the problem but not the solution. And, if solution should lie in this direction, should such a method be applied to all securities?

If the suitability of the present theory of valuation is admitted, the problem seems to resolve itself into finding the answers to the following specific questions involving the valuation of private placements:

1. What is the proper formula to determine if a bond is or is not amply secured?
2. In the case of bonds determined not to be amply secured or in default, what is the proper formula to apply to determine an acceptable market value?
3. What is the proper formula to determine an acceptable market value for preferred stocks?

Whoever succeeds in establishing these three formulae will have conferred a great benefit on both the supervisory authorities, the companies and the policyholders.

Generally speaking, there seems to be time for thorough study. The quality of private placements has not shown itself, in the opinion of investment oficers, to be such as to warrant fears that any significant number of issues will fall outside the amortizable class for a long time to come. Nevertheless, the problem is an important one. As I have previously indicated, a strong committee is studying its ramifications and I am optimistic that the solution will close one of the gaps at which operating officers are at the disadvantage of not knowing what the rule of the game is to be.

In closing let me repeat. In a field where there has been so much discussion, there are bound to be strong differences of opinion. I hold no brief before this audience for any group. I want to express my praise for the splendid job which Dr. Fraine has done in shedding new light on a much discussed subject. I have tried to add a few scraps of detail which he may have felt, had he included them, would have expanded his paper beyond its proper length. I am sure that all of you will find in his paper, however, material which warrants reading in the quiet of your studies after having heard his presentation.

Discussion

by

Haughton Bell, Assistant General Counsel. The Mutual Life Insurance Company of New York

There has been so much discussion, much of it seemingly based on a lack of understanding of the facts about direct sales of securities and a rather vague feeling that these sales may be giving institutional investors "economic power" over the business of the issuers, that as full and well rounded a paper as Professor Fraine's should be welcomed in all quarters. Actually, as he has shown, direct sales furnish an exceedingly simple, flexible and useful means of financing. I am sure that from the standpoint of institutional investors, the more that is known about direct sales and all that they involve, the better.

I shall confine what I have to say to direct sales to life insurance companies, since that marks the outermost boundaries of my knowledge of the subject. The gaps within those bounds will, I am afraid, be all too evident.

Furthermore, I am going to address what I have to say to direct sales by industrials, for several reasons. In the first place, they are far more common than sales by other corporations. In the period from July 1, 1947 to June 30, 1948, the period used by Mr. Silloway in estimating the percentage of direct sales which were offered to our company by investment bankers, the ratio of industrial corporations to public utilities seeking financing from us was 6 to 1. Furthermore, to an increasing extent, public utilities, the only other important class of issuers which has sought financing through direct sales, are being forced by law and regulation into competitive bidding, so that direct sales by them are of diminishing volume. Finally, most of the discussion or controversy relating to direct sales is, I believe, concerned more with direct sales by industrials than direct sales by public utilities and other publicly regulated corporations.

As I proceed with my comments on Professor Fraine's paper, I want to emphasize certain fundamentals which seem to me important to bear in mind in connection with direct sales.

The first is that every financing arises through the need of the issuing corporation for capital. The corporation is always the moving party. Its first step is necessarily to seek a market in which investment funds are obtainable. For industrial corporations, that market has changed very materially in the past 20 years, mainly for the reasons Professor Fraine has given.

But there is also another reason. I think it is fair to say that laws governing investments of what may broadly be termed fiduciary funds generally reflect accepted thinking with regard to what constitute sound investment outlets; and further, that significant changes in those laws generally reflect significant changes in that thinking. It was just 20 years ago, in 1928, that two changes occurred in the

investment laws of the financially conscious State of New York which may be said, I believe, to have marked the opening of a wholly new field to industrial corporations in search of long term capital. The first, which has only an indirect bearing, was a change in the law governing the investment of savings bank and trust funds, always the most strictly circumscribed. Prior to 1928, the only securities of private corporations in which savings bank and trust funds could invest were the bonds of railroad companies, which are traditionally and almost invariably obligations secured by mortgages on physical property. In 1928, for the first time, some public utility bonds were added to the legal list. Much the more important change was a 1928 amendent to the Insurance Law of New York. Prior to that time, life insurance companies had been permitted to invest only in obligations which were adequately secured, either by physical property or by other securities. By the 1928 amendment, life insurance companies were permitted for the first time to invest in what might be termed credit obligations, where the lender looks to the continued earning power of the borrower as reflected in its past earnings record rather than to physical security.

This latter change directly affected life insurance companies incorporated in New York, and also though somewhat more indirectly and loosely, life insurance companies incorporated in other States but licensed to do business in New York. The importance of the change is evident, when it is recalled that, although some industrials finance by bonds secured by adequate physical security, most industrial obligations are credit obligations, either debentures or else bonds where the mortage is thrown in more or less as a make-weight and the principal reliance is on the earning power of the borrower.

The new market of investment funds opened to the industrials by these changes in law and accepted investment practice was much smaller in 1928 than it is today. This is shown strikingly by a study of the 18 largest United States life insurance companies, which Dr. James J. O'Leary, of the Life Insurance Association of America, published last month. From this study it appears that in 1928 these 18 companies had total admitted assets of just under $13 billions. Slightly less than $5 billions (stated in terms of cost) was invested in securities. Only $175 millions, or about 1⅛% of admitted assets, was in "industrials and miscellaneous." At the end of 1947, the assets of these 18 companies had grown to more than $41 billions, of which almost $31 billions was in securities (chiefly Governments), and "industrials and miscellaneous" had grown to approximately $4.6 billions, or about 11¼% of admitted assets. It has been estimated by the Life Insurance Association of America that, at the end of 1948, the holdings of "industrials and miscellaneous" by all United States legal reserve life insurance companies will be over $7.3 billions, or 13.2% of admitted assets.

Therefore, when an industrial is seeking long term capital, it now has the choice to which Professor Fraine referred—either it can seek to obtain the capital through the mechanism of a public offering provided by investment bankers or it can seek to obtain it by a direct sale in a very sizable market.

As Professor Fraine pointed out, each method has its advantages and its disadvantages. Every industrial seeking capital will naturally

weigh the relative advantages and disadvantages of the two methods as it sees them, and as long as individual managements form opinions, there will be some who will decide in favor of one method and some who will decide in favor of the other.

Professor Fraine has pointed out the principal factors to be considered in making a choice, but individual opinions may even differ as to which of these factors is an advantage and which a disadvantage. For example, I could hardly be expected to agree with him that it is a great advantage to a corporation which believes that it may have to seek further financing at some later time to have its first securities issued to the public. I should be inclined to say that it would be a better stamp of credit to have had the first issue in the hands of such discriminating investors as life insurance companies. If I should be accused of special pleading on this point, I would call attention to Professor Schumpeter's remarks last evening when he said that because a man is an advocate, it does not necessarily follow that he lies, or words to that effect.

Furthermore, I think that the mere fact that institutional investors are able to get stiffer covenants in indentures cannot be considered a disadvantage to the borrowers without taking into account at the same time the advantage to him of the flexibility which inheres in direct sales and which Professor Fraine also mentioned.

Others might have different opinions on these and other points.

I wish to comment briefly on his reference to the disadvantage to institutional investors arising out of the possibility that securities purchased directly may be harder to sell than securities which have been registered with the Securities and Exchange Commission and sold publicly. Although the evidence on this point is rather meager, this disadvantage probably tends to be overemphasized, because there is always difficulty in selling blocks of securities of the size which institutional investors hold, whether the securities have been distributed publicly or by direct sales. There has been no real market for large blocks on the exchanges in recent years, and almost the only way in which such blocks have been moved has been by finding other institutional investors who are willing to buy them. It is much less important to institutional invesors that securities have not been registered and publicly issued than it is to individual investors, because the institutional investor generally makes and depends on its own investigation whenever it buys securities. There have been comparatively few sales of directly placed securities, but sales have taken place, and, while the absence of a public market may be some handicap, it now appears to be a rather minor one. It is possible, however, that in a different economic environment there would be more of a public market for large blocks of securities, and under those conditions any reluctance on the part of individual investors to buy securities which had been directly purchased by an institution might be a greater disadvantage than it is today. There is a compensation, however, in the fact that in most direct sales there are good sinking funds, and these sinking funds benefit the institutional investor directly. Under a public offering, sinking funds are applied to purchases determined by lot or by tenders, and no single holder can be sure that

he will benefit directly from the sinking fund. In this respect, direct sales have a distinct advantage over publicly offered securities.

I shall not repeat what Professor Fraine had to say about two of the advantages, namely, the saving of the expense, which generally tends to be shared by the borrower and lendor, to the benefit of both, and the ability of the borrower to get an early commitment. The latter comes high on the list of advantages to a prospective borrower in uncertain markets, but, even in them, imposes no disadvantage on a long term lender who, have no intention to resell, is not affected by temporary fluctuations in the market and aims only at getting the average yield at which investments are being made. The institutional investor indeed usually makes it a point to give a prospective borrower a commitment (subject to verification of facts and to legal details) as soon as it has satisfied itself that it will make the loan.

I want to go at greater length into the final advantage ,or set of advantages, which come both in the initial stages of negotiation and making of the loan and also through the entire life of the loan, because of the direct relations between the parties. *The second fundamental* to be borne in mind is that, as the name of Professor Fraine's paper implies, *the parties at all times deal directly with one another.* From the standpoint of the borrower, this makes direct sales the easiest and most natural way of obtaining financing. From the standpoint of the lender, they afford the purest form of investment, where lender deals directly with borrower.

From the lender's standpoint, this direct dealing has, in the initial stages, a great advantage over purchase of a publicly offered security, because it means that he gets better acquainted with the business and management of the borrower than he could hope to get where the securities are purchased in the market. In the second place, the lender gets better covenants, negotiating directly with respect to his needs and with keen realization of the fact that he intends to hold the securities to maturity. The borrower is willing to accept more stringent covenants, because, as Professor Fraine has pointed out, he knows that if occasion arises, he will stand a better chance of getting the covenants adjusted than if the securities were held publicly. Then any change might be obtainable only through a refinancing of the issue. Of course, direct sales are not negotiated on the theory that a lender will agree to adjustments of the covenants just for the asking, but the borrower knows that if the institutional investor continues to hold his securities, he will get an unbiased hearing from a financially experienced investor to whose self-interest he can appeal if changed conditions make a change in the covenants desirable or financially sound.

It is important that the loan contract be thoroughly understood, both the circumstances under which the contract is made and the terms of the contract, because it governs the entire subsequent relationship between the parties. ..*The third fundamental is that the contract is entered into by the borrower and the lender on a strictly arm's length basis and sets forth the terms and conditions on which the lender is willing to make the loan and the terms and conditions which the borrower is willing to accept in order to get the loan.*

Before the lender will lend, it must satisfy itself that the borrower's

credit is good. In arriving at this decision, it necessarily conducts a careful study of the borrower's history, not only the market for its products, but also the financial policies and practices which the borrower has followed. If the lender decides to make the loan it does so because of three factors. One is that it is satisfied with the continued ability of the borrower to make money; the second is confidence in the management of the borrower; and the third is an agreement by the borrower that it will maintain a sound financial structure and will also continue in the future some approximation of the sound financial practices which it has followed in the past and which have made it an eligible credit. The contract is aimed at preserving a sound financial structure and sound financial practices. Nevertheless, the contract does not attempt to establish standards under which the management of the borrower would have no flexibility. The contract, therefore, is intended to set up normal standards for financial structure and practice designed to afford an adequate margin of safety for the loan. At the same time, these standards are also intended to give the management of the borrower a maximum of freedom in the conduct and operation of its business. The lender never wants to interfere with the management of the borrower. As just stated, one of the principal bases of credit lending is confidence in the borrower's management, and it is to the lender's self-interest, as much as to the borrower's to enable this management to continue to manage the business without interference, unless a point is reached where the borrower's financial condition has so deteriorated that repayment of the loan becomes jeopardized.

Up to this point, I believe no one who has the slightest knowledge of these transactions has seriously said that the investor exercises any "economic power" over the borrower. The lender has purchased debt obligations of the borrower which carry no voting power. It has never been the practice of life insurance companies to place a representative on the Board of the borrower; I know of no single exception. In this respect, the life insurance companies are in a different position from the investment bankers, who usually have a stake in the stock and for that reason may place a representative in the management of the borrower. The life insurance companies have no such interest and have no representation in the management.

The charge that the life companies may exercise "economic power," however, is probably directed at the situation which may be expected to exist after a borrower has encountered adverse trends and a breach of covenant is threatened. The charge is so vague that it is hard to pin it down, but I believe it is aimed at what may follow from this point on. This question of "economic power" will, however, stand the most thorough examination.

This brings us to *the fourth fundamental, which is that the entire dealings between the parties are at all times framed within a purely debtor-creditor relationship. The insurance company is solely a creditor.* That must always be borne in mind.

As I said a moment ago, when the loan contract is made, the lender and the borrower agree, in an arm's length bargain, that the borrower will live up to the covenants set forth in the contract which are intended to assure, so far as possible, the preservation of a sound financial

structure and the observance of the normal rules of sound financial practice. This agreement of the borrower has induced, and been a condition of, the making of the loan.

From this point on, experience is meager, because we have been through prosperous business times, and what I shall say from now on represents principally the opinion of one lawyer and his associates who had something to do with the preparation of indenture covenants. I can at least say what has been aimed at and how I think the situation will develop. This speculation is, however, supported by a few instances from which to date we have gained some experience.

When a borrower's financial condition approaches a point at which one or more of the covenants will be broken, the covenants begin to make themselves felt. The first impact of the covenants will, as a rule, be to cause the borrower to put itself through a process of self-examination. This is likely to be a prelude to an approach to the insurance company to ask it to waive a covenant—for example, to lower the net working capital requirement. Before doing so, the issuer will naturally examine the causes of the adverse trend which has resulted in the weakened financial condition and will analyze the result likely to be produced by the covenant waiver.

The next impact of the covenants will be when the borrower and the lender meet and begin to talk the situation over. It seems to me that it makes no difference whether the borrower comes in to see the lender or the lender goes in to see the borrower, although to date, the approach has generally been made by the borrower.

The purpose of the meeting is clear. It is to discusse the situation in order to get at the facts and to see what can be done. If there is any doubt that the causes of the adverse trend have been correctly or completely diagnosed, and in the experience to date, they have not always been, the discussion will be directed to a search for the root of the difficulty and the remedy. This is likely to take the form of a review of the ABC's of sound financial practice. This is particularly likely to be the case when one of the smaller companies has found itself in difficulties; in such a company the executives generally know very well how to run the business, but they are not always well versed in financial practice. For example, we might ask them whether they have reviewed all segments of their inventory, whether they are spending money too fast on capital improvements or should slow up till more accounts receivable are in, whether they have carefully analyzed the results of projected capital outlays, whether they have analyzed their overhead thoroughly. Possibly, after one source of trouble has been found, we might suggest—although, in our experience to date, the suggestion has come from the borrower—that independent engineers be engaged to see if there are other weaknesss and to rcommend remedies or improvements.

All this is general conversation. It is the kind of talk a borrower has with its local bank. The borrower will probably already have been in consultation with its bank before it comes to us. Invariably the bank has been in the discussions at the same time we were. It is simply the ordinary discussion which a corporation almost necessarily has with persons conversant with financial principles when something is

going wrong with its financial position. They do not ask us to run their business for them and we do not ask them to let us; we could not ,if we would, perform this highly individual and specialized function of management. We simply don't know enough about their business and would never attempt to interfere in running it. They have as keen, or an even keener, self-interest in curing the financial fault as we have; and we must rely on them to straighten the business out. Furthermore, we have no *power* whatever to force them to do anything, since no breach of covenant has occurred.

It is true that the loan contracts in direct sales frequently contain covenants which will be broken before an acutely critical stage in the financial affairs of the borrower has been reached. This is intended to give the lender either a chance to get its money out while the borrower can still repay it, or, if this is not possible, at least to provide a chance for curing a remediable situation while the borrower still has enough liquid assets to do so. This, to repeat is one of the conditions on which the loan is made. At most, it differs only in degree from the conditions made with underwriters in a public offering. It does not differ at all from the conditions on which term loans are generally made by commercial banks. Any attempt to prevent the imposition of such a condition in the contract would be equivalent to declaring that it is against public policy for a long term lender to make a contract under which steps can be taken to safeguard its investment before a stage of financial deterioration has been reached at which it is impossible for the borrower either to repay the loan or to take remedial action. Stated differently, it would mean that there is a public policy in favor of freezing a long term lender into a business and compelling it to leave its money there at risks which are wholly foreign to the theory of a creditor relationship. It would place the long term lender, who lends its money at a low rate of interest, at the risk of the business on a footing only slightly better than the stockholder, who is compensated for his risk by an unlimited chance at profit.

The next impact of the covenants is reached when a breach of covenant actually occurs. If the borrower has had its securities distributed publicly, a breach of a major covenant almost inevitably means bankruptcy. Where the securities are held by one or a few investors, on the other hand, much greater flexibility is possible, and this flexibility, with possibly the modification of the contract, provides a means for expert handling of financial difficulties. After the breach has occurred, the lender does have power to enforce its contract rights, if necessary by judicial proceedings, and any such enforcement would almost inevitably lead either the borrower or the lender to file a petition in bankruptcy. If the parties can agree on what course shall be followed without going to court, however, it is all to the good. Certainly there is no public interest in having a corporation go into bankruptcy or other judicial reorganization proceedings if it can be prevented. Courts of bankruptcy and the bankruptcy law exist for the purpose of reconciling differences between debtors and creditors or various classes of creditors when these differences cannot be reconciled outside of Court. But if the difficulties can be reconciled outside of Court, it is to the public interest to have them so reconciled. From

more than 10 years' experience in railroad reorganization proceedings, I can say with feeling that judicial reorganizations are exceedingly expensive, time-consuming and altogether cumbersome affairs. Judges have been among their most severe critics, and if such a proceeding can be avoided, it is very decidedly in the public interest, as well as in the interest of the parties, to avoid it.

Therefore, when you analyze it, you come inevitably, I believe, to the conclusion that the lender can exercise no economic power in the sense of domination of the management of the borrower when the breach of a covanent is threatened or even after one has occurred. The lender can only suggest to the management what may be wrong. The lender can give general advice as to how to remedy it, but the lender has no power which the existence of the Bankruptcy Act does not give every creditor to persuade the borrower to do anything. I submit that to the extent the lender exerts this influence, it is doing a very salutory and economically desirable thing and one which it would be equally, or almost equally, in a position to do if it held publicly offered securities. If the securities were offered through underwriters and the lender held a large block, it might, of course, go around and talk to the issuer when the lender saw trouble approaching, but, because the securities were publicly held, the issuer would probably be much more reticent in talking to one security holder. In the first place, it might feel that it would lay itself open to an accusation of discrimination through giving only one of a number of security holders the facts; and probably more important, the issuer might fear that discussions with one or more creditors would be likely to spread the rumor that it was in trouble and this, in turn, might depress the market for its securities and injure its credit. Nevertheless, there is no reason why any large holder of securities cannot make suggestions to any issuer whose securities it holds where it sees adverse trends appearing. A holder of publicly offered securities could not take the affirmative step of putting the issuer into bankruptcy as early, but by the same token, it would be less able to suggest—never compel—a remedy where the issuer's situation was remediable.

Moreover, there is a solid foundation for the assumption that the insurance companies will not be likely to abuse whatever rights they have under their indenture covenants. This is found in the fact that of all accumulations of capital in this country, there is probably none which has been less prone to interfere in matters of management of other companies than the life insurance companies. Before any attempt should be made to withdraw or restrict these rights, it is submitted that there should be some indication of serious abuse. To date, evidence of abuse is lacking, and reason seems to indicate that institutional investors should be encouraged rather than discouraged from making contracts aimed single-mindedly at the protection of the funds entrusted to them by millions of policyholders, who benefit from sound investments, which are repaid, and who are injured by investment losses.

Direct Sales of Large Industrial-and-Miscellaneous Bond Issues

by

Eric C. Vance, University of Rochester

Because of Professor Fraine's excellent coverage of the causes and consequences of the growth in the over-all total of private placements, and the further valuable contributions of my fellow-discussants on that subject, I believe it best to limit my remarks to certain aspects of the changing composition of the total.

Since about 1940, total private placements of public utility securities have decreased materially in relative importance; direct sales of railroad securities have remained relatively low; and, as Mr. Bell has implied, direct sales of industrial-and-miscellaneous issues have accounted for a larger and larger share of the total.

Of the latter group, a growing proportion has been in large bond issues. As a result, private placements of large industrial-and-miscellaneous bond issues have mounted very rapidly, not only relative to total private placements but also in comparison with total available new offerings of such bonds. This latter development has attained such proportions as to merit further consideration, especially inasmuch as large private placements in general have received relatively little attention.

Much of the literature of the field has dealt primarily with relatively small issues: those under $5,000,000. This is quite understandable. It is in this type of financing that the insurance companies have contributed the greatest innovations: innovations which, as Professor Fraine indicated, made funds available to many enterprises for whom conventional long-term financing would have been difficult or impossible. Then too, as Professor Fraine noted, there are many more of these relatively small issues in insurance company portfolios than there are of large private placements.

But the larger issues, while fewer in number, account for a much greater aggregate dollar investment. Most of these issues, moreover, could have been floated without too great difficulty through regular investment banking channels. Hence their direct sale has proved more painful to the investment banking fraternity. And it is in the industrial-and-miscellaneous classification that the most spectacular inroads have been made.

Direct sales of industrial and miscellaneous bond issues of $10,000,000 or more, with maturities of over five years, as compiled by the writer from the detailed monthly reports of the Commercial and Financial Chronicle, have been as follows over the past decade, in relation to total offerings of such issues:

	Private Placements†	Total Offerings†	% Privately Placed
1939	$ 78	$ 405	19%
1940	154	646	24
1941	106	461	23
1942	131	333	39
1943	108	213	51
1944	274	549	50
1945	530	956	55
1946	959	1,760	54
1947	1,133	1,398	81
1948*	1,294	1,519	85

(† in millions)
(* first 11 months)

This evidence of spectacular growth to a position of almost complete dominance is striking. Admittedly, the data used may lack perfect completeness and accuracy. But one would appear fully justified in accepting the general trend that they show, and in concluding that direct sale currently is accounting for well over 80% of all offerings of large industrial-and-miscellaneous bond issues.[1] This percentage, it will be noted, is about twice that estimated by Professor Fraine for private placements of all sizes and categories of issues in 1948.

Now, to what may these developments be attributed?

One contributing factor has been indicated by Mr. Bell: the policy of many life insurance companies to increase the proportion of their funds that is invested in industrials, presumably for greater diversification and increased yield. Because of the size and rate of growth of insurance company assets, this would require very heavy purchases. Private placements apparently have been found to be an attractive means of effecting these purchases. And large issues typically entail lower acquisition and supervision costs per dollar invested than do small issues.

Although insurance company purchases of public utility bonds also have been heavy, most of them have been effected through investment banking channels. "Direct" purchase of most such issues would require competitive bidding, thereby preventing the more desirable direct negotiation of indenture provisions. And typically, utilities provide for little, if any, compulsory debt amorization: sinking funds usually are small and frequently may be invested in property additions. Consequentuy most utility issues offer less than industrials to compensate for the lack of marketability of privately placed issues with its consequent decrease in liquidity.

Granting the existence of a heavy demand for industrial bonds by insurance companies, why should the large industrial issuers prefer to supply this demand directly rather than through investment bankers?

1. Possible types of reporting errors would include the omission of an issue and the reporting of an incorrect face amount. Omissions are least likely in the case of large issues, however. If some issues have been omitted they are more likely to have been privately than publicly placed issues; in which case the effect would be to understate rather than overstate the proportion privately placed. Face amounts reported were checked against other sources for key periods.

Professor Fraine has pointed out, among the advantages of private placements, the possibile sharing of savings in marketing costs and the greater flexibility in setting up or later modifying the terms of the issue.

He also mentioned, as did Mr. Bell, the advantage of avoiding the SEC 20-day-waiting-period requirement, especially in times of uncertainty generated by shaky bond markets. There is considerable evidence that this last factor is an important one, and Professor Fraine might well have given it greater weight in his appraisal of the influence of the Securities Act upon direct sales. Over the past six years, for example, one could discern a marked tendency for the privately-placed proportion of the total offerings of large industrial-and-miscellaneous bond issues to expand considerably in periods when the bond market was weak, and to contract somewhat during periods when rising security prices were generating greater investment confidence. It will be recalled that since late 1946, bond prices have not exhibited much confidence-inspiring strength.

Still a fourth factor may have played a fairly important part: the difficulty in effecting equity financing. When a corporation issues bonds by necessity rather than by preference, it is more likely to think in terms of fairly rapid amortization of the debt, hoping for better equity markets later on in which to finance further asset expansion and replacement. Hence assumption of the substantial sinking fund or serial-maturity obligations characteristic of most private placements may seem less of a deterrent than it would under normal conditions.

In closing let us ask what all this implies as to the future. May institutional investors continue to count on directly absorbing increased amounts of large industrial and miscellaneous bond issues? My own guess is that such private placements may well be near their peak. Industrial needs for new funds seem more likely to decline than to increase. Then too, many industrial enterprises lack the earnings and assets characteristics suitable for the assumption of heavy annual debt-reduction obligations. Furthermore, improvement in the bond market would lessen the handicap imposed upon public offerings by the SEC waiting-period requirement, thereby weakening one important advantage of private placement. And finally, any sustained improvement in the equity markets would reduce the pressure to incur debt and hence the willingness to amortize rapidly such long-term debt as is incurred.

When will the stock and bond markets improve substantially? Fortunately my time is up! At any rate, you can answer that question just as well as I can.

Part II — Review of the Year

Life Insurance

by

James S. Elston, Assistant Actuary, The Travelers Insurance Company

The United States legal reserve life insurance companies had about $207,000,000,000 in force December 31, 1948, it estimated by the Life Insurance Association of America. This includes $135,200,000,000 Ordinary, $32,600,000,000 Industrial and $39,200,000,000 Group. These figures include insurance in other countries, almost entirely Canada. The estimated total on U. S. residents, including that in Canadian companies, is $201,000,000,000, an increase of about 8% in 1948 and about 86% since the end of 1938. This total is distributed $130,400,000,000 Ordinary, $31,400,000,000 Industrial and $39,200,000,000 Group and Wholesale.

The new paid-for business of United States companies for 1948, not including revivals or increases, is estimated at $24,000,000,000, the new Ordinary being $16,200,000,000, the Industrial $4,650,000,000, and the Group $3,150,000,000. Again the total on United States policyholders is estimated at $22,700,000,000, within 2% of the all-time high volume of 1947 and higher than the 1946 record by about 3%. The average of the last three years is about 33% above the maximum for any prior year. Nearly all of the states in which the new business paid-for exceeded the 1947 figures are in the West and South. The insurance lapsed and surrendered was slightly greater in absolute amount than in 1947 but probably there was not a very appreciable increase as a percentage of the amount in force. The payments to policyholders and beneficiaries are estimated at $3,170,000,000, of which about 55% represents payments to living policyholders.

There is also about $8,200,000,000 insurance in force in fraternal orders and assessment organizations and $2,250,000,000 U. S. Government Life insurance on veterans of the First World War. The amount in force June 30, 1948, of National Service Life insurance resulting from the last war was something like $38,000,000,000. The amount of Savings Bank life insurance in force in Mass., N.Y. and Conn. is about $500,000,000.

Benefits under the Social Security system to widows, children, and others are paid, except for certain comparatively small amounts, in monthly income during widowhood, infancy, etc., as defined by the law. These payments are not usually considered as life insurance, but if the present value at date of death of such benefits were calculated, the total for all now covered has been variously estimated at from $60,000,000,000 to $100,000,000,000.

Every life insurance company was required to file before March 1 a very complete annual statement with the Insurance Department of every state in which it is licensed, but it takes months—even for organiza-

tions devoted to the compilation of statistics to assemble totals of all companies. The latest comprehensive statistics available, therefore, are for 1947.

LEGAL RESERVE LIFE INSURANCE—1947*

(Dollars in Millions)

Total Premium Income	$ 6,635	Real Estate	$ 860
Investment Income	1,562	Mortgages	8,675
Other Income	785	Bonds	36,757
		Stocks	1,390
Total Income	8,982	Collateral Loans	9
		Loans to Policyholders	1,937
Death Claims Paid	1,336	Cash	1,020
Matured Endowments	416	Deferred and Unpaid Premiums	784
Annuities and Disability	336	All Other Assets	311
Surrender Values Paid	390		
Dividends to Policyholders	567	Total Admitted Assets	51,743
Accident and Health Benefits	235		
		Liabilities	47,773
Total Paid Policyholders	3,280	Surplus‡	3,970
Other Disbursements	2,084		
Total Disbursements	5,364		

‡Includes amount set apart for dividends to policyholders during following year and special, voluntary, contingency, etc., reserves.

	Ordinary	*Industrial*	*Group*	*Total*
New Issues and Increases	$ 16,898	$ 5,193	$ 6,205	$ 28,296
Terminations:				
Death	966	230	206	1,402
Maturity	260	148	—	408
Surrender	1,075	730	19	1,824
Lapse	3,270	2,626	329	6,225
Other	1,196	311	300	1,807
Total	6,767	4,045	854	11,666
Insurance in Force	126,206	31,493	33,565	191,264

*Spectator Insurance Year Book—All United States companies (398).

Bruce E. Shepherd, Manager of the Life Insurance Association of America, at its annual meeting in December, analyzed the distribution of investments. It would be difficult, if not impossible, to cover this extremely important phase of life insurance operations better than to quote extracts from his address.

INVESTMENTS, BY CLASSES, 1945-1948
ALL UNITED STATES LEGAL RESERVE LIFE INSURANCE COMPANIES

	Dec. 31, 1945 % of Total	Dec. 31, 1946 % of Total	Dec. 31, 1947 % of Total	Estimated Dec. 31, 1948 Amount Outstanding	% of Total
Bonds—U.S. Government	46.0	44.9	38.7	$16,750,000,000	30.2
State, County & Municipal Bonds	1.6	1.3	1.2	850,000,000	1.5
*Canadian Gov't	2.6	2.6	2.5	1,430,000,000	2.6
*Other For. Gov't	.0	.0	.0	20,000,000	.0
Total Gov't Bonds	50.2	48.8	42.4	19,050,000,000	34.3
Railroad	6.7	6.1	5.6	2,975,000,000	5.4
Public Utility	11.6	11.6	13.4	8,650,000,000	15.6
Other	4.3	6.9	9.6	7,300,000,000	13.2
Total	72.8	73.4	71.0	37,975,000,000	68.5
Stocks—Railroad	.2	.2	.2	100,000,000	.2
Public Utility	.6	.7	.7	400,000,000	.7
Other	1.4	1.7	1.8	950,000,000	1.7
Total	2.2	2.6	2.7	1,450,000,000	2.6
Mortgages — Farm	1.7	1.6	1.7	1,025,000,000	1.9
Other	13.1	13.2	15.1	9,800,000,000	17.7
Total	14.8	14.8	16.8	10,825,000,000	19.6
Real Estate	1.9	1.5	1.7	1,050,000,000	1.9
Policy Loans & Premium Notes	4.4	3.9	3.7	2,075,000,000	3.8
Cash	1.8	1.6	2.0	850,000,000	1.5
Other Admitted Assets,	2.1	2.2	2.1	1,175,000,000	2.1
Total Admitted Assets	100.0	100.0	100.0	55,400,000,000	100.0

*Includes all political subdivisions.

The predominant flow of life insurance funds since the end of 1945 has been into private investments, i.e. corporate securities, mortgages and real estate. This trend, greatly accentuated in 1948, has occurred in response to the capital needs of corporations and individuals as the nation's expenditures on private domestic investment—largely for producers' durable equipment and new private construction—increased by about 80% between the first quarters of 1946 and 1948 and since have been maintained at that level.

"A net increase of $6,527,000,000 in outstanding corporate security, mortgage-loan and real estate investments of all life insurance companies is estimated for this year, as against corresponding increases of $4,761,000,000 in 1947 and $2,346,000,000 in 1946. In both 1947 and 1948

such increases have been substantially larger than the total increase in assets. Thus in these two years life insurance companies have been able to place in private-enterprise investments not only all new funds coming into their hands but also sizable amounts of additional funds. Decreases in holdings of government bonds (foreign and domestic combined) of $1,566,000,000 in 1947 and of about $2,909,000,000 in 1948 account for the availability of funds for private investment in excess of total new funds.

"Real estate mortgages have been the second largest investment channel for life insurance funds in the post-war period. Sharp increases in expenditures for private construction in 1946 and 1947 and further moderate increases in 1948 have been an important factor in the active demand for mortgage credit during these years. The 1948 increase in the mortgage holdings of life insurance companies is estimated at about $2,150,000,000, which is over ⅓ larger than last year's increase and about 4 times as large as the 1946 increase.

"Although life insurance companies have increased their real estate holdings by nearly 50% in the last two years, such properties at the end of 1948 will make up only about 1.9% of their assets and will total about $1,050,000,000. Until recently ownership of real estate by life insurance companies was restricted to property used in the conduct of the companies' business and to properties acquired in satisfaction of debt. Within the past few years, however, a number of states have revised their laws to premit these companies to acquire real estate for investment purposes. Acquisitions for such purposes of both residential and commercial properties more than account for the 1947 and 1948 increases— of $125,000,000 and $190,000,000 respectively — in the total real estate holdings of life insurance companies. Well over half of the real estate held by such companies at the end of 1948 will represent properties acquired for investment purposes. Such properties will then include a somewhat larger volume of commercial than residential real estate.

"The 43% reduction in the earning power of life insurance funds from a rate of 5.03% in 1930 to 2.87% in 1947 reflects two long-range trends, namely, the severe decline in the general level of interest rates and the great increase in the proportion of federal securities held by life insurance companies. In the short-range view, some moderate improvement is observable in the much smaller decrease in the earnings ratio in 1947 than in any of the preceding four years. The likelihood that the 1948 ratio, when it becomes available, will show a further braking of the investment earnings decline is suggested by the further increases this year in the percentages of life insurance company assets invested in private enterprise as well as by the moderately improved general level of interest rates for 1948 as a whole as compared with 1947. It should, of course, be recognized that yields obtainable on new investments weight the overall average only to the extent of the proportion of new to total investments. In general, moreover, the lag between changes in the level of interest rates generally and their reflection in investment earnings ratios is greater on the up trend than on the down. This is because on the down trend of interest rates the adverse effect on life company earnings is accentuated by swollen ratios of new to total investments in their portfolios as a result of refunding opera-

tions of borrowers seeking the advantage of the lower interest rates.

"For life insurance policyholders the reduced level of life insurance company investment earnings has meant lower dividends on their policies and higher premium rates on contracts purchased in recent years. To express this sacrifice in concrete terms, we may estimate that, based on the 49-company experience, total net investment earnings of all United States legal reserve companies in 1947 alone were $1,045,608,000 lower than they would have been at the 1930 earnings rate level. This difference is nearly twice as large as the amount of dividends actually distributed last year and nearly ⅔ greater than the amount of first-year premiums on policies purchased in 1947. The sacrifice policyholders are bearing as a result of the higher cost of life insurance is doubly onerous in view of the fact that at the current low level of dollar purchasing power—also a war inheritance—a policyholder needs about 45% more insurance than he did in 1930 to give him equivalent protection in terms of the things life insurance is needed for."

In a report a year ago, the Institute of Life Insurance said: "Rental housing for more than 100,000 persons in 23 projects and representing an investment of more than a quarter of a billion dollars is now either under construction or in the planning stage by the life insurance companies of the country. Rental housing projects already completed by the life companies and now occupied provide housing for nearly 100,000 persons in 24 projects. They represent an investment of $138,000,000. The largest number of these projects is in New Jersey, with New York, California and Ohio next in line. Eight of the projects not yet occupied are now under construction and represent housing for an estimated 70,000 persons. This will involve a planned investment of $172,000,000 by the life companies. In the past year, several life insurance companies have undertaken this type of investment for the first time and projects have been started or planned for several states not previously listed. The life insurance company projects constructed, under way or planned, represent a total rental housing from approximately 200,000 persons and an investment of more than $400,000,000. These projects number 47 and are located in eleven states."

The Life Insurance Association of America has also analyzed the regional distribution of investments of companies having 89% of the assets of the business December 31, 1947:

	% Life Ins. Investments in U.S.	% of U.S. Population By Area	% of Reserves for Policies in Area
New England	6.0%	6.5%	8.8%
Middle Atlantic	25.1	20.1	33.9
E. No. Central	21.2	20.5	23.0
W. No. Central	8.9	9.5	8.7
So. Atlantic	12.3	13.6	8.4
E. So. Central	5.8	7.5	3.2
W. So. Central	8.9	9.7	3.8
Mountain	2.9	3.1	2.1
Pacific	8.9	9.5	8.1
	100.0%	100.0%	100.0%

These companies' regional investments including cash and miscellaneous assets, at the start of 1938 and 1948 together with the ratios of these investments to regional policy reserves, are reported by the Association as follows:

	Investments Jan. 1 1938	% of Reserves	Investments Jan. 1 1948	% of Reserves
New England	$ 1,195,724,000	60.5%	$ 2,550,084,000	72.6%
Middle Atlantic	6,678,676,000	87.4	10,549,972,000	78.6
East North Central	4,744,437,000	102.8	8,952,827,000	98.0
West North Central	2,710,821,000	146.2	3,775,306,000	109.6
South Atlantic	2,129,683,000	126.5	5,189,616,000	155.1
East South Central	1,203,212,000	175.0	2,436,648,000	193.4
West South Central	1,429,505,000	213.8	3,788,745,000	254.6
Mountain	586,301,000	142.6	1,234,084,000	150.3
Pacific	1,562,649,000	107.9	3,748,496,000	116.2
U. S. Total	22,241,008,000	106.0	42,270,778,000	106.5
Total*	24,141,991,000	110.3	46,278,581,000	113.7

*Including Investments in territories, possessions and foreign countries.

In this analysis, U. S. Government securities are allocated to each area according to population, railroad securities according to area mileage covered by the specific issues and the utility and other corporate securities according to location of the properties securing the investments.

The Life Agency Management Association has analyzed the full time employment in life companies as:

	Jan. 1, 1946	Jan. 1, 1947	Jan. 1, 1948
Home Office			
Men	26,700	32,700	35,300
Women	53,800	61,700	66,100
Total	80,500	94,400	101,400
Agency Cashiers and Clerks			
Men	3,200	3,900	4,300
Women	26,800	28,900	30,200
Total	30,000	32,800	34,500
Agents and Agency Managers			
Men	143,500	165,200	173,225
Women	7,200	5,300	5,275
Total	150,700	170,500	178,500
Total:			
Men	173,400	201,800	212,825
Women	87,800	95,900	101,575
Total	261,200	297,700	314,400

Several interesting compilations, some based on special requests to the companies for information, have been made by the Institute of Life Insurance. The current premiums are the equivalent of just over

3% of the total national income in the U.S., while in 1941 they were almost 4% and in the '30's were an even higher percentage. The average for 1930-39 was 6%.

"More than $625,000,000 of the past year's life insurance benefit payments were used by policyholders of U. S. companies to set up continuing income plans for the future, the largest sum ever used in this way. The 1947 funds used in this way were 64% greater than five years ago.

"These funds represented 44% of all ordinary and group life insurance death benefits and endowments, the source of most of the funds available for income plans. Total funds set aside by policyholders with all U. S. life insurance companies for future income use had increased to $4,200,000,000 at the start of this year, a rise of $400,000,000 during 1947 and nearly double the total of five years ago.

"Hundreds of thousands of American families are now benefiting from these payments. In 1947, some $385,000,000 was paid out by all U. S. life companies as installments due in that year under income plans already set up.

"Nearly one-tenth of all the Ordinary and Industrial life insurance in force is fully paid-up protection, the Institute reports. The total at the start of the year was $14,640,000,000, involving 22,000,000 policies. Of this, $11,250,000,000 on 6,000,000 policies was on Ordinary insurance, the balance on Industrial. These amounts are 9% of the total Ordinary and 11% of the Industrial.

"At the start of this year, the annuities in force numbered 3,269,000. They represented $1,009,000,000 of annual income, the first time that the total had topped the billion dollar mark. It is believed that the 1948 payments will exceed last year's payments of $220,000,000. Total funds set aside by annuitants with all U. S. companies, including accumulated interest reached $7,250,000,000 by the start of this year.

"Greatest growth during the past year, as for several years, was in group annuities set up by employer-employee groups as voluntary retirement plans. Covering 1,943,000 workers at the start of this year, for aggregate annual income of $372,000,000, they have more than doubled since 1941. Individual annuities still constitute the greatest part of aggregate payments provided. Annuities of this type in force at the start of this year numbered 1,162,000 and provided $563,000,000 of annual income. This compares with 951,000 individual annuities for annual income of $477,000,000 in 1941.

"Of total annuities owned January 1 of this year, 627,000 annuities, representing $236,000,000 annual income are fully paid for and are now paying income; 2,027,000 annuities representing $400,000,000 annual income are fully paid for but provide income to begin at some future date; and 615,000 annuities representing $373,000,000 annual income were still being paid for and will provide future income.

"Analysis of ordinary insurance policy issuance shows that 95% of all applicants were issued policies. Of the total issued, 90% were standard rate policies and 10% extra rate policies. Physical reasons combined accounted for over three-fourths of those who did not meet qualifications. Chief causes of these were: cardiovascular-renal, between 40% and 50%; medical history, 20%; overweight or underweight,

5%: Less than 5% were for occupational hazards and the balance were for other underwriting reasons, including application for too much insurance in relation to finances, location of residence, or habits regarded as harmful.

"Life insurance ownership varied widely with occupation, age, education, income, and residence," the Institute reports. "This is shown in a special tabulation covering life insurance of all types, prepared for the Institute by the Survey Research Center of the University of Michigan, based on the 1948 Consumer Finances Survey made for the Federal Reserve Board. Income is naturally one of the most important factors, as that in large part measures the ability to pay. While 78% of all U.S. families own some life insurance, 93% of those earning $5,000 to $7,499 own life insurance. The percentage is smaller for those in lower income brackets with 45% of those earning under $1,000 owning some life insurance. Ownership of maximum amounts of insurance is indicated in the group earning $7,500 or more.

Occupation involves several relationships, such as income levels, insurability, need for insurance. Among the occupational groups analyzed, professional persons, business men, managers, clerks, salesmen, skilled and semi-skilled workers, all showed about the same percentage owning policies, between 86% and 88%. Professional, business and managerial ranks, however, put larger amounts into premiums. Unskilled workers showed 70% owning policies, more of these being in the smaller premium groups. Farm operators and retired persons showed 60% and 50% insured respectively, also with premiums tending to smaller units.

"Both over-all ownership and the relative size of premiums paid varied with place of residence. Metropolitan centers showed the lowest percentage paying smaller amounts of premiums and the highest percent paying larger amounts. They also showed the highest over-all ownership, with 85% of families in such cities owning some life insurance. There was a generally descending ratio of over-all ownership as the size of the community decreased, with families living in open country showing 62%.

"Education has a direct relation to ownership; college graduates showed a materially greater ownership than those with grammar school education only, both as to over-all ownership and the paying of larger amounts of premiums. This was true in the case of varying income groups as well as for the totals.

"Family size also appeared as a factor, life insurance ownership growing with numbers in the family up to a unit of four or five persons. In such cases, about 85% own policies and their premium payments indicate larger amounts. Families of three persons showed very nearly the same percentage owning policies, but a tendency towards smaller premium outlays. Families of six or more show 73% owning some insurance; single persons show 60%. The word family used in this survey means spending unit comprising all persons living in the same dwelling, related to each other and pooling their incomes to meet major expenditures.

"Employer-employee groups representing over one-fourth of all civilian non-agricultural workers in the country now have some form of pension or deferred profit-sharing plan in operation," the Institute

reports. "This is shown in an analysis made by the U. S. Treasury Department covering applications filed by employers for tax benefits applying to pension plans. At mid-year last year 10,608 of these pension or profit-sharing plans had been filed with the Treasury Department and more than 10,000 of them had received Treasury Department approval for tax purposes. The total number of workers in the firms with the pension and profit-sharing plans was well over 11,000,000 and the number of these actually participating in the pension or profit-sharing benefits was nearly 4,000,000. The rapid growth of pension plans in recent years has stemmed from a number of factors, including the influences of Social Security benefits which provide a base on which to build a retirement income; the increasing recognition of management's responsibility for aiding its workers to plan and develop their economic security; and the effect of taxes," the Institute commented. "With pension plan interest now widespread, competition in the field of working conditions has also become a factor.

"Of the actual pension plans, more than 80% are life insurance plans, using either individual contracts of life insurance or group annuity contracts. The group annuity contracts averaged 600 covered workers and accounted for more than one-fourth of covered employees. The firms using individual policies accounted for three-fifths of the pension plans, but they averaged much smaller worker groups, with the result that they represented only about 6% of covered employees. Fewer than 1% of the pension plans were self-administered, but they accounted for half of the covered workers."

A committee representing the American Life Convention, American Mutual Alliance, Association of Casualty and Surety Companies, Bureau of Accident and Health Underwriters, Health and Accident Underwriters Conference, Life Insurance Association of America, Life Insurers Conference and National Fraternal Congress of America has just made the first comprehensive report of the number of persons insured under some form of voluntary protection against loss of income due to sickness or accident in the U.S. on December 31, 1947.

"Insurance against Loss of Income Due to Sickness or Accident

Insurance Companies and Fraternal Societies	18,714,000
Paid Sick Leave—In Private Industry	4,560,000
In Civilian Government Service	4,490,000
Employee Mutual Benefit Associations	1,460,000
Union Plans and Other Employer-Employee Methods	2,000,000
Total	31,224,000

Hospital, Surgical and Medical Expense Coverage

	Hospital	Surgical	Medical
Insurance Companies, Hospital Insurance Companies and Fraternal Societies—			
Personal	10,548,000	8,687,000	1,463,000
Dependents	10,275,000	6,651,000	606,000
Total	20,823,000	15,338,000	2,069,000

Blue Cross Plans and Plans Sponsored by Medical Societies			
Personal	12,355,000	3,260,000	1,495,000
Dependents	15,631,000	3,820,000	1,490,000
Total	27,986,000	7,080,000	2,985,000
Other Organizations			
Bituminous-Coal Industry—Personal	190,000	224,000	224,000
Dependents	250,000	300,000	300,000
Total	440,000	524,000	524,000
Consumer Sponsored	1,600,000	1,600,000	1,600,000
Industrial, excluding coal mining	1,260,000	1,220,000	1,215,000
Private Group Clinics	375,000	385,000	405,000
University Health Plans	100,000	100,000	100,000
Grand Total	52,584,000	26,247,000	8,898,000

Individuals covered solely by Government insurance under compulsory plans have not been included in the total number of persons protected against loss of income due to sickness or accidents. Data obtained indicate that more than 4,000,000 workers were engaged in covered employment at the end of 1947 under the Rhode Island and California cash sickness plans and under the Crosser amendment to the Railroad Unemployment Insurance Act. Of these, it is estimated that about 2,000,000 are counted under one of the voluntary plans covered by this survey, while the remaining 2,000,000 were protected solely by a compulsory plan.

"Also omitted from the survey are various types of protection such as those listed below which were not considered appropriate for inclusion in this study but which, nevertheless, provide many dollars in benefits to the injured and disabled.

"Workmen's compensation providing protection to the majority of wage earners against occupational accidents and diseases.

"Total and permanent disability benefits included in many life insurance policies.

"Commercial accident policies providing disability indemnity and other benefits in event of accidental injuries, approximately 4,000,000 in number.

"Commercial accident policies covering travel hazards and other specified risks, over 3,000,000 in number.

"Complete medical care for persons in the armed forces.

"Complete medical care for persons in public institutions.

"Medical care and disability pensions available under certain conditions to war veterans.

"Protection under automobile and all other types of personal injury liability policies.

"Medical payments provisions under many automobile, residence liability and other types of liability policies."

New Jersey adopted a non-occupational cash sickness disability plan somewhat similar to that of California. This might be discussed more under the subject of social insurance though in these states much of the coverage is written under various restrictions by the group in-

surance departments of life insurance companies. The only other state where such coverage is compulsory is Rhode Island, where the plan is a state monopoly. Similar proposals are now before the legislatures of a dozen or more states, some for a monopolistic state fund and others for a state fund in competition with private carriers. In the more important states already, and probably in most, if not all the others, both types will be considered before such laws are passed.

New York increased from $3,000 to $5,000 the limit on a single life that may be written there by mutual savings banks which, however, will be subject to the same statutory requirements as life insurance companies there.

There were two unusually important actuarial events in 1948. About fifty American and Canadian actuaries, mostly American, attended the centenary celebration of the Institute of Actuaries of Great Britain, the famous British actuarial body which has had a worldwide influence on actuarial science, and has helped so materially in making life insurance the tremendous factor it has been in building the life insurance structure to its present eminence. Americans presented papers on all the subjects covered and took an important part in the discussions.

The Actuarial Society of America, founded in 1889, and the American Institute of Actuaries, founded in 1909, admission to which by examination establishes the position of life insurance actuaries in the United States and Canada, have been cooperating more and more closely, most committees having been joint for several years. They are being merged into the Society of Actuaries, which has already been organized.

After the Social Security Act was originally passed, question arose as to whether life insurance agents were covered, the general question being whether they are employees or independent contractors. Decisions varied between companies, depending on the agents' contracts, the amount of supervision over agents, etc., most decisions being that they are not covered. Interpretations were gradually "liberalized" and in 1948, when it appeared that bureau regulations might be drawn to bring them and various other borderline occupations under the provisions of the law, Congress passed the Gearhart Resolution which reaffirmed the intent of Congress that for a person to be considered an "employee" under the act, he must come within the common law relationship of master and servant. It seems to be generally expected now that no matter how much of President Truman's proposed extension of the Social Security Act is approved, this particular Gearhart Resolution will be repealed.

1948 set a new low record for mortality, according to the experience among the many millions of Industrial policyholders of the Metropolitan Life Insurance Company in the United States and Canada. Last year was the fifth in succession to show an improvement in mortality (exclusive of enemy action). The death rate for the year was 6.5 per 1,000 policyholders, as compared with 6.6 in 1947, the previous low. The improvement was quite general. Among white females, virtually every age group recorded a lower death rate in 1948 than in 1947. The declines ranged from two percent at the oldest ages to almost 20 percent for the group 15 to 24 years. The marked improvement in mor-

tality among young women was due, in good measure, to the sharp drop in the death rates from tuberculosis and accidents, as well as to the decline in maternal deaths. Among white male policyholders, a decrease in mortality occurred in all but two age groups. At ages 35 to 44 years, the death rate remained practically unchanged from the year before; at 65 to 74 years, the death rate was up 1.5 per cent from 1947. As a result of improved mortality conditions, the average length of life (the expectation of life at birth) among Metropolitan Industrial policyholders was 67.16 years in 1948, as compared with 66.86 years in 1947. The average has increased more than 10 years in the past two decades.

The Life Insurance Medical Research Fund was organized a few years ago in behalf of the life insurance companies, most of whom contribute to it annually. Nearly two million dollars have so far been allocated to research projects in various American and Canadian colleges and hospitals on the subject of cardiovascular disease, that is, on fundamental research on problems in disease of functions of the heart and blood vessels.

In last year's corresponding review, Mr. Alfred N. Guertin mentioned the status of the proposed new form of annual statement which, after seven years work and consideration of all suggestions by insurance companies and state insurance departments, is offered by the Joint Committee on Blanks of the Life Insurance Association of America and the American Life Convention to modernize and greatly improve annual statements. Work on the new form was undertaken to meet the increasing amount of criticism of the present form. The proposed form conforms far better to modern accounting procedures and is more informative to the companies, the insurance departments, and also the public.

The Internal Revenue Act of 1948, passed by Congress, should be studied by anyone having an estate large enough to be afected. It includes a marital deduction provision intended mainly to provide greater equality of tax treatment as between the community property tax states and the others. Whether or not the proceeds of an individual's life policy will be treated as community property and so result in smaller estate taxes is an extremely complicated legal question depending on the exact nature of the beneficial designation and of the trust agreement, if any. Furthermore, there may be circumstances in which an insured would rather sacrifice the possible tax reduction in order to be assured that his estate will be settled as he thinks best for his beneficiaries.

Expiration on June 30 of the insurance anti-trust moratorium of the McCarran Act is cited as one of the year's principal developments in a report by the special committee of the American Bar Association's Insurance Section that has been studying the newly acquired "commerce status" of insurance. The Federal anti-trust acts have become applicable to insurance to the extent that "it is not regulated by state law." Accordingly, the extent of the present regulation of insurance by state law is of considerable importance, especially the state rate regulatory laws, most of which were enacted as a result of the Commissioners' All-Industry Committees' studies. The report states: "Al-

though relatively few legislatures were in session in 1948, several passed laws which either enacted new rate regulatory statutes or broadened their existing state regulatory laws. Rate regulatory laws are now in effect in all forty-eight states, Alaska, Hawaii, Puerto Rico and the District of Columbia.

"The approval of a fair trade practices measure in New York made a total of eighteen states having this type of enactment. Statutes of other jurisdictions contain many of the component part of the model fair trade practices measure (such as a prohibition against false advertising, rebates, defamation of competitors, misrepresentations, etc.) to be found in various parts of the insurance code or chapters of the particular state. Laws along the line of the Clayton law, regulating ownership of insurance stock by other insurance companies and regulating interlocking directorates, were enacted in 1948 in Massachusetts, New Jersey and New York."

In a review of the year, published in most insurance periodicals, Mr. Clarence C. Klocksin added: "The Federal Trade Commission and committees of Congress are presently engaged in a study of the new as well as the old state laws bearing on the application of Fair Trade Practices to determine their adequacy. Congress has manifested no intention or indication to prejudice the situation and if legislation is found to be necessary in some jurisdiction an opportunity may still be given such states to meet the requirements of the Federal Act. The Federal Trade Commission held a conference early in December with mail order insurance companies doing principally an accident and health insurance business. The purpose of the conference was to afford that portion of the insurance industry an opportunity to cooperate with the Federal agency in establishing trade practice rules directed toward prevention of methods of unfair competition and other unfair or deceptive trade practices. It is expected another conference will be called by the commission early in the new year. "At their meeting in New York City, the National Association of Insurance Commissioners approved a report of its Federal Legislation Committee of a Uniform Unauthorized Insurers Process Act for adoption by the legislatures of the several states. At the conclusion of the meeting a special committee of five supervisory officials headed by Commissioner Forbes of Michigan went to Washington to confer with the Federal Trade Commission on the fair trade practices problem affecting the mail order insurance business."

Property and Casualty Insurance

By

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Since 1944, every year in the Property and Casualty insurance business seems necessarily, from the viewpoint of the big picture, to be judged by its place in the developments following the now famous South-Eastern Underwriters Association decision. By this token, 1948 was the year of orderly adjustment to rate laws and other changes in the fundamental status of insurance, with one serious problem appearing toward the end of the year. Other important developments were experiments in applying deductible coverages on a large scale and a general improvement in underwriting experience, with the possibility that the capacity problem had about worked itself out by the end of the year.

From the viewpoint of the big picture of the status of insurance, 1944 was the year of shock—the S.E.U.A. decision. 1945 was the year of analysis and congressional legislation—the McCarran Act (Public Law 15 of the 79th Congress), which gave the insurance business and the states a chance to work out a system of supervision. 1946 was the year of acrimonious debate over the course to follow and 1947 the year of state legislative action. Since most state rate laws passed as a result of these developments went into effect in 1948 and since the anti-trust law moratorium provided by the McCarran Act expired in July of that year, the position of 1948 as the year of adjustment becomes readily apparent.

Rate Laws

The McCarran Act[1] provided that the Sherman, Clayton, Federal Trade Commission and Robinson-Patman Acts shall apply to insurance only "to the extent that such business is not regulated by state law," and that these laws should not apply to insurance at all until January, 1948 (later extended to July, 1948), except that the Sherman Act should apply to any "act of boycott, coercion or intimidation." To provide state regulation necessary to meet this qualification, as far as rating is concerned, the National Association of Insurance Commissioners and the All-Industry Committee worked out model Fire and Casualty rating bills[2]. Subject to many variations, they were adopted in the majority of states, often superimposed on older legislation.

By the middle of 1948, every state had some form of rate law, although in two states—West Virginia and Idaho—there was still no rate regulation applying to Casualty insurance. Several states, in-

1 Discussed by the author in the 1946 Journal.

2 Discussed in the author's reviews in the 1947 and 1948 Journals.

cluding Missouri, Mississippi, Virginia, Rhode Island and the District of Columbia, passed new or supplementary legislation and New York revised its already stringent rate code to incorporate many features of the Commissioners-All-Industry bills.

Thus, except for Casualty insurance in two states, by the middle of 1948 all states had some form of regulation as to rates. Whether this is sufficient "regulation" to satisfy the requirements of the McCarran Act and thus protect cooperative action of insurance companies from the anti-trust laws remains to be seen. There are so many variations that no uniform answer—or even guess—is possible. Sooner or later, some of these laws will undoubtedly be tried in the courts. Many observers expect that at least some actions will be initiated—not by the federal department of justice—but by private citizens, perhaps by insurance men who are dissatisfied with the situation in some particular state.

Federal Trade Commission

The most important or at least most eminent threat of federal action appeared to be from the Federal Trade Commission. Of necessity, the insurance business and the commissioners had had to concentrate on rate making during the years immediately following the S.E.U.A. decision. There are hosts of other problems arising out of the application of federal laws to established insurance practices, which must be taken up later. The Federal Trade Commission, with its broad powers of inquiry into merchandising practices, has, in the opinion of many competent legal observers, supervisory power over the insurance business, since in the majority of states there is no "regulation" similar to this. To oust this jurisdiction, a number of authorities recommended that the states pass so-called "little F.T.C. laws," giving the insurance department or a newly created bureau similar authority. Only a few states seemed interested in such legislation, but a number passed fair trade laws, specifically outlawing various practices in insurance. More legislation of this type seems certain to be introduced this year. Since most of these laws include prohibition of coercion of placing insurance by mortgagees and other lenders, they have generally been supported and sometimes initiated by agents associations.

During 1948, the Federal Trade Commission showed its interest in insurance, but there is still no indication as to just what it will do. A congressional inquiry into Life insurance, which might easily have embraced other fields of insurance, seemed likely to peter out by early 1949.

One of the most likely targets for Federal Trade Commission action appeared to be insurers operating primarily through the mail. Although these firms write mainly Life and Accident insurance, Fire and Casualty insurance men followed these developments closely. The mail order carriers formed an organization known as the National Association of Insurance Advertisers, with Wendell Berge, former assistant attorney-general who had been very active in the S.E.U.A. case, as counsel. This organization took the first steps toward drawing up a code of fair practices and held several meetings with representatives of the Federal Trade Commission, but nothing conclusive had developed by the end of 1948.

Problems in Rate Supervision

Although heralded by practically every insurance journal as the beginning of a "new era," the actual development of rate laws coming into force was practically unnoticed by the average insurance man, particularly those in the producing field. Most of the readjustments in constitution, etc. necessary for a rating bureau to function as a semi-public organization, instead of a private association, had been made by the majority of rating bodies well in advance. Both insurance supervising officials and insurance men directly concerned with rating operation showed marked cooperation and patience and there was little disposition on the part of anyone to make trouble. As far as the average insurance producer was concerned, rate publications, forms, filings, etc., seemed to come through just about as smoothly and just about on the same basis as before.

An interesting development, particularly in most Middle Western states, was the incorporation of audit bureaus into the rating organizations. The Commissioners-All-Industry fire bill authorizes rating organizations to provide for the examination of policies, daily reports, etc. to determine if the prescribed rates and rules have been complied with and to require correction of violations. In many Middle Western states, this work had been done previously by separate audit bureaus maintained by the companies. Where the new laws were in force, the audit bureau became the audit division of the rating bureau, with the same personnel, and scarcely anyone noticed the change.

Without question, the majority of public officials recognized the importance of making state supervision work. The high caliber of appointments following the change of administration in many states last fall was graphic evidence of this. In two states, career men in the insurance departments were raised to the commissionership. And nearly every insurance department with a new rate law made a serious—and usually successful—attempt to get competent men, well versed in insurance, to administer the rating section. Many observers expect that before too long positions in state rating divisions will be as accepted a starting point for insurance technicians as government posts are now for attorneys and accountants.

Interstate Rating

The first major problem to develop under rate laws—and at the time of writing it is still unsolved — was the rating of interstate risks. During the months of debate on rate laws in general and the Commissioners—All-Industry bills in particular, many opponents, particularly those interested in handling large nation-wide risks, had claimed that the proposals would run into trouble at this point. However, in the vast majority of cases these persons had Casualty insurance in mind, particularly Automobile, Public Liability and Workmen's Compensation insurance for country-wide risks. Little attention had been given—at least in public utterances—to complications in Fire insurance.

Prior to 1948, Fire insurance on the contents and other personal property of most interstate non-manufacturing risks had been handled through the Interstate Underwriters Board or through similar arrangements of non-member insurers. The I.U.B. had always maintained that it was not a rating organization. It calculated a single country-

wide rate for each risk on the basis of values and applicable rates at the various locations and filed this rate in such states as might be necessary. The insured received only one policy (or set of policies, if more than one insurer was involved), but underlying policies were filed in such states as required this.

Even before the new rate laws, the I.U.B. had been criticized by insurance departments and other authorities. There were many charges against its methods of computing rates, which were claimed to be indefinite, often influenced heavily by competition, weighted by unwarranted reductions in unregulated states to offset the rigidity of other states, etc. None of these charges had been officially proven, but the situation at least left plenty of room for discussion, even if rate laws had not made the matter critical.

The I.U.B. first sought recognition as an advisory organization in practically all states having rate laws. (An advisory organization, under the Commissioners—All-Industry bills, is one which assists in rate making by furnishing statistics, etc., but does not actually make rates.) A number of important states refused to accept this, claiming that the I.U.B. actually made rates and consequently should be treated as a rating organization. After months of argument, as 1948 drew to a close, the I.U.B. withdrew itself completely from the picture, with its manuals, forms, rates, etc. It was succeeded by the Multiple Location service organization, established as a purely advisory organization.

Proposed Solutions

At the risk of oversimplifying the reams of studies and proposals, there appeared to be two basic proposed solutions to the problem. One was to recognize interstate business as something entirely distinct from other Fire insurance business and to authorize one or more nation-wide rating organizations to handle the business accordingly. (Substantially similar proposals had been made for Casualty insurance by opponents of the Commissioners-All-Industry bills.) The other basic proposal—built largely around the argument that interstate business accounts for a relatively small proportion of Fire insurance premiums—was to permit covering interstate risks under a single policy or set of policies, but to let the rates in each state stand on their own feet.

Conferences among representatives of all interested parties—insurance commissioners, insurers, producers and buyers of insurance—failed through 1948 and into early 1949 to reconcile the differences. Hence, at the time of writing, the Fire insurance business still is without any universally accepted formula for handling interstate business, although a few carriers have filed their own plans.

A number of expedients were devised to meet the situation temporarily. During the fall of 1948, a number of nation-wide lines which had expired were held under binder. In the closing days of 1948, most state rating bureaus filed forms and rules substantially similar to those previously used by the I.U.B. These filings abolished the distinction between Interstate and Single State Multiple Location and Reporting forms. It is intended that, when and if some interstate rating system is worked out, the same forms will be used for risks in a single state and those in two or more states.

At present writing, the only procedure available to all insurers is to write separate policies for each state, covering the locations of the insured in that particular state. Practically all states authorize blanket average rates on property at two or more locations in the state.

From a practical viewpoint, the situation, although acute, was not as serious as it might have been from a public relations viewpoint, because of the capacity problem. Many large firms were already having difficulty getting their values covered and thus were willing to accept protection which covered their values, even though the premium might have been higher than under previous interstate methods. This situation, however, will not continue forever. Practically every observer agrees that, unless the Fire insurance business works out an acceptable and equitable method of protecting interstate risks, these powerful insureds will eventually rebel. It may mean resorting to foreign and unlicensed insurers or it might mean an appeal to the federal government to establish by law some sort of national rating bureau. An increase in the practice of self-insurance is another possibility.

Deductible Coverages

Last year the writer pointed out that the base of Fire and Casualty insurance protection has been so tremendously broadened—due to a combination of more people carrying insurance and broader coverages—that every disaster, no matter how minor the aggregate damage, is bound to bring about far more insurance claims than ever before. By 1948, many insurance authorities had begun to question whether this was desirable, in view of the burden of handling many small claims. Several windstorms of that year put tremendous loads upon adjusting organizations and in some cases caused all organizations to pool their resources in certain localities.

The result of this situation was a sentiment for deductible coverages, which were adopted as to some forms in some territories. This was particularly true with windstorm losses. Every windstorm brings many instances of minor damage to roofs and other property in the area. With the spread of Extended Coverage (separate Windstorm insurance is now practically extinct) there were hundreds of small claims following every windstorm in which the expense of adjusting the loss equalled or exceeded the amount of the loss itself. Deductibles—usually $50 for each loss—had been in force on Windstorm insurance and the windstorm portion of Extended Coverage in Texas and Florida prior to 1948. During 1948, this principle was extended to the balance of the southeastern states and to New England. Sentiment among the insurance business as to the desirability of deductibles is far from unanimous and it is impossible to foresee how universal these rules will become. In some states, these deductibles can be removed for an additional premium—usually with a minimum requirement too high to be attractive to the average dwelling insured—while in other states they are mandatory on all contracts.

These deductibles naturally raised some technical problems as to the interpretation of policies. Such matters will undoubtely be ironed out, but the fundamental argument will probably go on for years. On one hand, the point is made that the purpose of insurance is to protect

people against losses which they cannot afford, that paying small losses, which are relatively costly to adjust, result in everyone paying more for insurance than necessary and in many cases becomes a form of maintenance rather than insurance. The counter argument is that, however correct this position may be fundamentally, the public likes to collect from insurance companies and would sooner pay the additional cost of this service than not have it, that actually paying a small loss is the finest public relations work in which insurance companies can engage and that anything which will reduce such contracts between the companies and the public will eventually increase the chances of adverse political action.

Similar arguments, of course, apply to coverages such as the Personal Property Floater and Residence and Outside Theft insurance. Although no formal action was taken with either of these coverages, optional deductibles have been available there for some time and many companies worked hard to promote the sale of these contracts on a deductible basis.

Experience

In general, underwriting experience during 1948 was somewhat improved, although final figures were not available at the time of writing. The increased volume of business enabled most companies to show a decreased expense ratio, which was also expected to help in annual statements.

The capacity problem, although not completely solved, seemed much improved by the end of 1948. Property values generally had ceased to rise and, in the Fire insurance field, the running out of three year and five year policies meant releases of unearned premium reserves, which also eased the problem. Some observers believe that, with reserves released and values not likely to rise sharply during 1949, many companies may be making concerted drives for new business before the year is over. Most carriers have been able to build up their field forces and are in good position to do this.

The Automobile insurance picture also seemed to have improved, although it could not be said at the end of 1948 that most companies were again aggressively soliciting the business. Rate increases, plus the inflated value of new automobiles and the exhorbitant cost of repairs—a combination of rising costs and the construction of new models—may add political complications to Automobile insurance. With the premium for Liability and Material Damage insurance on new cars in many localities well over $100 and with financial responsibility laws making Liability insurance close to a necessity, there are possibilities for explosive political agitation—particularly if public purchasing power drops—which no thoughtful insurance man dares overlook.

Coverage Changes

An important development in Liability insurance was the introduction of the Storekeepers Liability policy early in 1948. This contract covers completely the liability exposures of the average store with only a single premium factor—area of the store. It is the first contract since the Garage Liability policy—brought out about 25 years ago—intended for a specific and numerous type of risk, with a simplified method of calculating the premium. In this respect it differs from the Com-

prehensive Liability policy, which may be written for almost any business risk, but which requires a separate premium calculation for each liability exposure.

The Storekeepers Liability policy also incorporated two features which had been in the Comprehensive Personal Liability policy for sometime, but which were new to commercial contracts—inclusion of Medical Payments coverage as a standard part of the contract and a single liability limit. This limit applies per accident, with no separate limit per person and no separate Property Damage Liability limit. If the contract is successful, it very likely will prove the forerunner of others for specific classes of insureds.

A Farmers Comprehensive Personal Liability policy, similar in principle to the Comprehensive Personal Liability form, was also introduced. Very likely, the insurance business, aided by lawyers and juries, is just moving into a stage in development of Liability insurance for rural risks comparable to the situation with city dwellers and business risks generally of the last decade or so.

The Residence and Outside Theft policy, which had turned into a money loser for most carriers, was revised and somewhat reduced in coverage. The manuals of Liability insurance were completely rewritten, but few substantive changes made.

In the Fire insurance field, while interstate risks got the bulk of attention, there were a number of detailed changes in rules and forms. The Extended Coverage endorsement is in the process of being revised in state after state, while in Business Interruption insurance a number of rule and form changes were made, particularly as to non-manufacturing or service risks.

Social Insurance

by

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I. *INTRODUCTION*

This is the fifth of these annual summaries. Each time I have given a name to the year. This time I find myself in a quandary—torn between "the year of promise" and "the year of the unmet challenge." As 1948 started, the new Advisory council, appointed by the Senate Finance Committee, promised much. As 1949 gets under way, 1948 seems to have been "The Year of the Unmet Challenge."

II. *"THE MANDATE"*

The election returns of November are said to have given a mandate to the Congress to set up new liberal programs and to liberalize old ones—comprehensive social security coverage. Apparently "liberality" means arranging benefits largely in excess of what the recipient pays for. Social Security is not all. There is a demand for Veterans pensions of $90 a month. During the year John L. Lewis with Federal assistance got $100 a month for his miners. Now H. R. 2893 provides a maximum benefit of $150 a month for an aged couple, but apparently as much as $120 a month will be possible for a single individual. The existing Old Age Assistance provisions of the Social Security Act permit grants of considerable magnitude, with Federal subsidy up to $30 a month. Cogitating in the manner of the unregenerate Scrooge, "there is an apparent belief that the banks are closed, that the insurance companies no longer exist, that the stock and commodity exchanges have shut down, that the personal thrift is entirely dependent upon government."

III. *THE AMERICAN SCENE*

Figures for the "national income" run as high as $220,000,000,000 for nearly 150,000,000 persons in the population of 1948. Crudely this indicates a per capita income of $1,500 a year or $125 a month. Taxes for wars past and future and for the frictional costs of government might hammer this down to about $100 a month as a "living income." One-fourth of the higher figure or a little less than a third of the lower figure would run to about $30 a month, representing a high enough proportion of such income to route to a man through the Federal government as a floor of protection. These American people have assets of real estate, government bonds, bank savings, life insurance contracts and other resources—especially their skills and their freedoms. There are virtually unlimited opportunities for productive employment. The Anglo-Saxon democracies have carried forward the belief in the individual, and a sturdy dislike of government as the source of a livelihood. Social Security has not yet been a very important factor in meeting presumptive needs here, save as relief channels are used with needs tests.

During the year, 1948, Old-Age and Survivors Insurance had paid out about $600,000,000, or about .3% of the national income. Federally subsidized Public Assistance, though, had found over 3½ million beneficiaries among the aged and dependent children, who absorb benefits at the rate of $125,000,000 a month or about 1½ billion dollars a year. This is not straight-forwardly labeled *relief*, but it is interesting to consider that, horror-stricken in the prosperous twenties at nearly 100,000 persons in the almshouses, we have now set up charities so accessible that in this set of facilities we have 35 times as many Federally subsidized reliefers as that almshouse population of 100,000 which has not greatly dropped. The 1½ million beneficiaries of OASI can individually be said to have made a purely nominal contribution as insured persons, to the cost of the ultimate benefits for themselves and dependents. In a sense they are "reliefers" too (and they get less than the Public Assistance recipients). Both sets together are receiving about 1% of the national income through OASI and PA. The total collected taxes of OASI, from employers and employees were smaller than that total outlay of $2,000,000,000 for the aged, the orphaned and dependent children, and the widowed mothers. Perhaps the Federal subsidy for Public Assistance could be said to have come from those OASI taxes. There are state and local payments too. An oppressive feeling of unreality permeates the atmosphere.

The recommendations of the 1948 Advisory Council to the Senate Finance Committee are singularly uninspired and liberal enough, while the further liberalizations of H.R. 2893, unenthusiastically sponsored by Chairman Doughton, seem to have been delivered to the legislators either in a mood of bravado or one of "after me the deluge."

These two complementary measures together have the joint defect of class legislation instead of the virtues of true national legislation. Under both the liberalized bills current benefits are negligible in comparison with the potential billions of the century's end. Its capriciousness, its anomalies, and its discriminations are flanked by both flaunting and insidious appeals to cupidity, rather than to that sense of personal responsibility which alone can bear the burdens of our great national economy. The methods of financing have previously been scored as dishonest, while the wastefulness inherent in the ponderous record-keeping leads into various unsound techniques. In spite of repeated defenses of the mechanism and philosophy, the criticisms will not down. The detractors are accused of being tools of the "special interests," the defenders as being entangled in the coils of bureaucracy. And all the time the four million already retired aged decent citizens, who refuse to ask for relief and have been denied insurance benefits, find their buying power reduced by the inflationary trends, without redress.

IV. *SIGNIFICANT EVENTS OF THE YEAR*

A. *Railroad Retirement and Civil Service Retirement Liberalization.* Since the establishment of a special retirement program for railway employees under Federal direction, and the consistent exclusion of these railway employees from the responsibilities—as well as benefits—of the Social Security Program of Old-Age and Survivors Insurance, it has been common to refer to this class legislation as "Social Security," and

to imply that granting one pressure group higher benefits is both legitiment and in the public interest. This use of governmental direction was twice declared unconstitutional in respect to the first two bills, the United States Supreme Court ruling on the first, and the District Court on the second. The rather smart "guinea-pig operation" for one set of favorites might establish precedent for further special case favoritism. Under directed collusion between the railroad managements and the dominant railway unions the basis of the third law was determined, the management agreeing not to ask for a test of constitutionality. Later, the State Unemployment Compensation programs were raided, taking away the coverage on the railway employees, and establishing a separate and different Unemployment Compensation program on railway employees alone. Still later, temporary disability and survivor benefits were added. In 1948, without increasing contribution rate from a level probably inadequate for the already established benefits, the retirement benefits were increasd by 20%, while the contribution rates for Unemployment benefits, wholly paid by the Railroads, were drastically reduced. The employees seemed happy to get more, and that painlessly, the employers must have been baffled and shamefaced, but only the taxpaying consuming public is thoroughly at sea. A perfunctory Congressional hearing before the House Interstate and Foreign Commerce Committee seems to have been held at extremely short notice, following the final decision of the Committee, reached before the hearing.

A drastic increase in the benefit scale, and certain additional benefits were also accorded the Civil Service employees—most of them—in their plan, with a definite increase in the employees' contribution rate. In addition to the mere jockeying to get more benefits, the major reason for these amendments seems to have been to make sure that the Federal employees would not take over broad social security sharing and risk adjustments in civil service benefits. So two effective pressure groups close to the Washington scene appreciate that the OASI program is also class legislation, and they "will have none of it." These groups have in fact shown some perception of the financial hazards of a complete nation-wide program. It must be paid for by all of us.

B. *The Advisory Council on Social Security*

The Advisory Council on Social Security was appointed by the Committee on Finance of the United States Senate, under authority of the U. S. Senate of the 80th Congress Resolution 141. The council numbered 17 members, including Chairman Stettinius and Associate Chairman Slichter, the executive Director, Council of State Governments, three others—in addition to the Chairman and Associate Chairman—from institutions of higher learning, six from business, manufacturing and financial institutions (of which only one was an insurance man), a scientist, one from Workmen's Compensation, one from the National Planning Association, and only two from formal labor organizations. Less than half had previously been members of these Advisory Councils or attached to the Social Security Administration itself. Yet the Social Security Administration furnished working staff to assist the Council and rather logically seems to have carried a considerable conviction in favor of existing "fundamentals."

These busy people dealing with these issues in a matter of days —as had been the case with the previous Council to some extent—had no time to telescope the essential years of discipline and training, required for sound discussions, into those brief periods. There is no evidence that hearings were held, as was the case with Beveridge, and there is evidence that some reports submitted were not even read by important members of the Council.

Four separate reports have been made by the advisory council dealing respectively with Old-age and Survivors Insurance, Permanent and Total Disability Insurance, Public Assistance and Unemployment Insurance. There are thus reports on three existing facilities, consideration of a fourth—"permanent total disability," better designated as "extended disability"—but a scrupulous ignoring of "Medical Care." As a sort of post-script to the Unemployment treatise, the temporary disability protection is considered (a back-ground of linking U.C. and T.D. exists in Rhode Island, California and New Jersey). The 200 pages of consideration are readable, show consideration on many fronts, show statistics that do not seem to have registered completely—particularly the actuarial story with its heavy but indeterminate deferred burden. There also seems to be no weight of the bitter lessons of other foreign experience. A selection of their recommendations can be made:

1. The reduction of the excluded categories, moving creakingly toward universal coverage, but still leaving out today's already retired aged.
2. Maintenance of giving more to those who have more—individual equity.
3. Maintenance of that clumsy barrier, the insured status, though adjusting it somewhat.
4. Lowering minimum retirement age for women from 65 to 60.
5. Moving boundaries of the formula upward and increasing percentages.
6. Continuing the discrimination against women and children.
7. Introducing "Permanent Total Disability" in OASI with cautionary notes.
8. Emphasizing value of rehabilitation.
9. Adding a fourth category of Public Assistance—as a catch-all.
10. Under Unemployment Insurance, increasing protection, removing restrictions, studying rating and reserve problems.

These are of course technical subjects, where the "feel" is a matter of long discipline and a cost-accounting appreciation. The operation of the whole Social Security program in the general improving employment conditions of the last dozen years has not subjected any of the systems to any true "work-out"—benefits have been low, and income steadily rising. The OASI selection leads clearly to a heavy snowballing of benefits. Public Assistance has shown a persistent growth as we have moved into better times, a surprise to those had expected it to fall constantly from the outset. OASI payments rose rather gradually from zero, under the improving employment conditions of the war. The more rapid upturn in both OASI and PA following the war suggests that as to the potentialities of these programs, "we

ain't seen nothing yet." We have yet to enter a period of high unemployment benefits, so that commonly an unqualified and unfounded optimism exists as to the potential strain under these programs. The combination of small aggregate benefits, low contributions and large reserves, though they are completely absent in the heavy drains of Public Assistance, give a superficial rationalization for doubling benefits. It has happened before. The nonchalence here is like that of the old assessment carriers, the stakes much higher—the safety of the country itself. The Finance Committee may well object to the lack of concern as to finance. The Doughton Bill H. R. 2893 has gone way beyond the liberalizations of the Advisory Council, which had shocked this reviewer.

C. *The Nation's Health*

The moot questions of Federal handling of Medical Care, which were discussed in an Inter-Departmental Conference in 1938, came up again in a huge conference of 1948, called the National Health Assembly, under the direction of the Administrator of the Federal Security Agency. Before the Assembly, it was announced that no carefully prepared conclusion would be reached by the conference. Probably had a vote been taken, most of those present would have opposed the approval of "Federal Insurance." The Administrator's Report to the President on the provision of Medical Care, "The Nation's Health," refers to the Assembly, says that the recommendation is made by the Administrator himself. The implication seems to be that everything is covered under the "insurance," that a nominal contribution will be collected for three years, before benefits are established, but that, save for existing limitations on personnel and equipment, everything medical is then to be furnished—and the "best" furnished everyone with fine catholicity. This is enough like the deferments of OASI to be significant. The opponents protests of bad faith and trickery must be seriously considered, for "an insurance plan" which begs the questions of cost and administration and specific benefits naturally arouses scepticism. Medical Care as we know it can involve hospitalization, surgical benefits, dentistry, optical needs, pharmaceutical supplies, appliances, home nursing, extra hospital nursing, diagnosis, the use of doctors at home, office and clinic, the special needs of chronic cases and very extended disability. "Insurance" implies money and financial structures, technical expertness. In the last few years the discussion of an "insurance plan" in the non-cost-minded Senate Committees dealing with Labor and Education, so as to avoid discussing costs with the Senate Finance Committee or the House Ways and Means Committee has been a major anomaly. The financial conditions of patients and doctors alike have been in constant flux. There seems to have been a very rapid expansion of non-governmental shared cooperation. At last a few joint statements on the current status of these "private" facilities are appearing, and there is hope for more. There is evidence of growing effectiveness in Life and Casualty insurance companies, in Blue Cross and Blue Shield, among employers and among unions. The American Medical Association is analyzing the scope and accessability of Doctors. We have lacked both qualitative and quantitative information, and much of what has appeared has been very hard to interpret. The uses of the statistics remain fearful

and wonderful. Those of us who know the errors and bias in vital statistics, and the artificiality of many of the indices, are constantly astounded at the apparent trust various people have in the exactness of this "mariner's compass" — statistical maturity arrives slowly. Wallace's 60,000,000 worker goal was reached. Perhaps Ewing's goal of saving 325,000 lives a year may be reached too. During the past year or two the non-governmental approach has been more promising than the governmental one, but on neither side has there been enough research. Perhaps the Brookings Institution will follow its "The Issue of Medical Care Insurance" by a further study, and the Wilson and Pumley treatises on the scope and facilities of medical care suggest more may be done in those quarters, while joint analysis by the Blues, the "commercial companies" and all the rest, must be continued indefinitely. They need to know about each other, not only for conpetition, but also for cooperation soundly designed to reduce the governmental expansion. When the welfare of the nation is at stake, we can well accord the will and the manpower for skillful analysis. In these areas the "snappy epigram," the "sententious truism" are not enough. Such beneficient enterprises as the insurance profession and the medical profession ought not to escape criticism. They should neither be ignored nor maligned. There is progress. There must be more.

D. *Bases del Programa de Accidentes de Trabajo en Guatemala.*

On October 20, 1948, an event of major importance on this continent was the publication of a workmanlike volume dealing with the underlying concepts of "Social Insurance" and "Social Budgeting," a meticulous and inspiriting evidence of mature appreciation of all the important features of these social benefits. The reviewer is a trifle red-faced because he has failed to do as well himself, and he hastens to accord tribute to the men who under great difficulties find it possible to make an outstanding contribution to democratic thought, to indicate with clarity the defects of the Central European thinking which has permeated North American writing, even as it shows its essential bankruptcy, both in the countries of its origin—Germany and Czechoslovakia—and in those of the copyists such as Greece, France and Poland. In other Latin-American countries sound protest is developing against the destructive attitudes of the bureaucrats, in apparently trying to smash existing privately handled insurances, and to substitute therefore more demagogic structures of "social insurance" with certain concomitant irresponsibilities for the admitted and well-understood limitations of the privately evolved patterns now in existence.

E. *Fringe Benefits.*

The United Mine Workers have also made history in establishing a plan for $100 a month to qualified retiring members, but with most of the existing logical beneficiaries barred from benefits, and being rather unconcerned that the resultant budget is lowest now when the resources are relatively great, and leaving the greater strain of the future to embarrass posterity when resources may well run low. The UAW-CIO also talks about $100, but perhaps inclusive of OASI benefits. These are not social insurances, but the loose terminology of this "business" tends to use terms applicable to very different entities as though they were inter-changable. A prominent actuary has written a

trenchant survey called "The Royalty Road to Pensions." It is truly essential to separate the "social provisions" from the "mass coverages" of employers, and groups of employers, and of unions, and both again from the strictly individual voluntary insurances. Health and Welfare Funds require adequate analysis by competent, disinterested parties —hard to locate, as some of those trying to find them begin to realize.

F. *A Sadder and a Wiser Public*

For the second time in a dozen years there have been some surprises in opinion polls, where the sampling methods seem to have lead to incorrect conclusions. This should not only make us wiser in a general way, but much less ready to admit the unsupported claims of "waves of the future," of the "mandates of the people," of "an already accomplished revolution." The nucleus of those making these claims is very small. The majority of popular votes did not go to President Truman. The opposition party had accepted these claims of the "prophets" rather too readily, and are said to have been ready to outdo the Democrats on liberality. The advance work upon which sound conclusions must be based simply has not been done. The opposition can now take advantage of sound "second thought" and help to slow down the unwisely constructed benefits now proffered. The Administrator of Social Security on his side has either been very trusting of his subordinates, or is taking some long chances on "talking down" to the people. An article in "The American Magazine" for January, 1949 called "More Security for You" seems either a carelessly written (or perhaps a very carefully written) defense of a heavily-managed economy. Such economies have not been noteworthy for lasting security, for democracy, nor for enhancing the dignity of the individual.

G. *A World Smashed by War.*

The United States, heretofore, with a minimum of regimentation has laid aside more and more of its freedom in the managed economy that goes with new deals and war. Many of the citizens are growing resentive over the delays in returning to the "free economy." But while the Federal government takes away many freedoms—except the freedom to pay our way as we go along (and that seems a bit menaced)—yet at the same time there are emergencies that bring sound discourse on the advantages of our free economy, in contrast to the managed economies of Europe. That is the case against Bismarckian precedent. It seems to have led the serf mind. So we "blow hot, blow cold." We know the sheer necessity for recovery everywhere else, and deep down in our hearts we want to get back to "pulling our own weight" as individuals, and encouraging the "out-of-the-procession" member of society also to get back into line and support himself. We also know from long training that the road to happiness is not the way of complete reliance on the state, but the major freedom from the domination of the state. It might be that we do not want the "carrot-before-the-nose" but rather such values as we can today have with sanity, paying for them now.

In this world the "catastrophes of ignorance" are making themselves felt. Great Britain can sense the aggregate effect of the all-purpose Social Security plan in a broad sharing of the limited supply of goods. Practically no one there has a comfort level of eating.

France with thirty years of planned housing finds that building doesn't get on. Germany with its class-ridden status and privilege derived from the State finds its income from Social Security funds most dependable as it comes from the ownership of real estate, and that real estate had been greatly damaged by bombing. Greece shows the bitter end-product of irresponsibly constructed "welfare funds," though they had claimed "actuarial dependability," Americans asked to save the funds and the faces of their sponsors, hesitate to recommended the only down-to-earth solution possible. Latin America, aping the shattered "social insurance" systems of Europe, tries to find an easy way—other than that of sound fiscal policy and realism—to show that the individual can be almost universally subsidized. This is not the time for the United States to make such promises for our children to keep—unless we are willing to do as well today as we expect our children to do in their day.

H. *The Hook Commission.*

One heartening recommendation was made by the Hook Commission on Service Pay for the Armed Forces—that the National Service Life Insurance be closed to new entrants, thus removing the Federal Government from further encroachment upon the individual life insurance business.

V. The First of March, 1949.

Chairman Doughton of the House Ways and Means Committee has presented two bills::

H.R. 2892. "To amend the Social Security Act to enable States to establish more adequate public-welfare programs, and for other purposes."

H.R. 2893. "To extend and improve the old-age and survivors insurance system, to add protection against disability and for other purposes (the act "may be cited as the 'Social Security Amendments of 1949' ")

Together these bills could involve approval of tremendous emergency outlays.

The final 1949 bill to deal with "The Nation's Health" has perhaps not yet been presented. S-5 is baffling. It is currently evident that the Bureau of Employment Security within the Social Security Administration is slated for transfer to the Labor Department, and that former recommendations to federalize the whole plan may reappear. (Perhaps the largess to the states under the fourth category of public assistances is designed to placate them for the loss of handling Employment Security, while the inclusion of Temporary Disability Benefits under OASI administration may be a similar sop to the Social Security Administration for the loss of Employment Security).

In this serious period of post-war recovery, with the tremendous commitments for past wars and current defense, the financial setting for these social security programs offers this major dilemma:

(a) to promise much for the future, committing posterity, while spending little today, or

(b) to do today what is being recommended for the future and face a tremendous increase now in Federal taxation.

The first choice seems essentially dishonest and irresponsible—for we

cannot control posterity, or make such promises for them, while the second choice requiring a direct facing of the financial relationships—the increasing current taxes, without the spending power for other purposes now carried in reserve increases—would be straight-forward and most unattractive to the Congress. Legislation should be postponed until the current rather than the next generation's needs are considered, and until Congress becomes more fully informed. It is to be hoped that these matters will not be handled in an atmosphere of haste and trading, as the hearings began, and that informed financial men will feel called upon to participate in furnishing advice to the Committee.

VI. *Personal Responsibilities and National Sharing*

As we face 1949 and the future, with inspiration from outside example at least as to what to avoid, we can look searchingly at what is being suggested in 1949, and particularly at the OASI actuarial cost estimates for the Advisory Council for the year 2000. Those illustrations of 10 billion and 15 billion are outmoded by the greater liberality of the new Bill. If Public Assistance benefits continue to be competitively higher than for OASI, the further addition of the catch-all fourth category of Public Assistance can run to huge outlays when the dikes inherent in the Unemployment Compensation formulas are broken down. An administration that can say with a straight face that "only 1 in 5 of our citizens can pay for medical care," if it can convince the citizens that such negation is true, is going to run into consumer resistance in making them pay. Regimentation, taking away personal responsibilities from our citizens, is far from an unmixed blessing. Rather, it is so much a "palliated curse," that it must be held firmly within bounds. We must be completely unwilling to let the destructive and demoralizing forces of the German regimentation go unchallenged in this country. Since the working people have more dollars than ever before, a sense of budgeting for personal responsibilities, a canvassing of the presumptive needs, a recognition of and a strengthening of the facilities that exist for dealing with them could go far to counteract that philosophy of complete helplessness that has been for many years the unattractive sales strategy of Social Security expansion. "Socialized medicine" is not the first step toward socialism. Other steps have already been taken. The wisdom of Federal provision for medical care does not soundly appear from the customary arguments so glibly but monotonously adduced. These various measures are linked. Insurance and medical men cannot assume that they are free from the necessity of understanding the affiliated Social Insurances. The insurance business, both life and casualty, has been all too tolerant of the use of insurance terms by non-insurance persons, and of the minimizing of the importance of the business itself. The value of a free society is that it is always progressive, it has never completely arrived, that choices — some good, some bad—are made by the citizens, but that the society has retained a sense of individual responsibility, and that its arrangements for mutual aid or insurance cooperation are voluntary compacts.

When we move on to a cooperative venture to embrace the whole country, the voluntary principle becomes strained, but Social Security has no proper setting in this democracy unless the spirit of voluntary, intelligent cooperation is preserved. This requires broad understanding

which we do not yet have. I have recently concluded another discussion on this subject, and I am concluding this one, with a very specific conclusion, wherein lies a challenge to our legislators:

VII. *Conclusion*

"Before the next social security legislation rides through to enactment, the informed members of the community must very firmly ask 'Why?' There sales resistance must be stiffened. We have seen too much of the 'inevitable', too many 'waves of the future,' to many 'appeasements'. To experiment before thinking on the problem is too expensive to risk today, for our resources are limited. Conservation is more intelligent than waste. We have been acting in recent years before very much thinking. At this point I recommend my high-school principal's advice to those taking examinations: 'Remember the order—read, think, and then act. Following that order—if you are prepared—you will pass the test' ".

Part III — Association Activities

Minutes of Annual Business Meeting

The business meeting was held December 29, 1948, 5 p.m., at the Hotel Cleveland, Cleveland, Ohio, the president, Dean J. Anderson Fitzgerald presiding.

REPORT OF THE SPECIAL COMMITTEE ON ASSOCIATE MEMBERSHIP AND RELATED MATTERS

At the request of Professor Hampton H. Irwin, Chairman of the Special Committee on Associate Membership and Related Matters, the minutes of the last Annual Meeting, as printed in the March 1948 issue of the *Journal*, were read in order to provide the members present with the necessary background regarding the purposes for which the committee was formed and its activities prior to the year just past. Mr. Irwin then presented the committee's report, which was duly accepted. (A copy of the report appears on page 107.)

It was voted to continue the Committee until the completion of the membership campaign, at which time it should be discharged.

In connection with the discussion of possible expansion of membership in the Associate classification, attention of the meeting was called to the proposed formation of an association of insurance company training officials. The meeting concurred unanimously in the view that such an organization would give the American Association of University Teachers of Insurance a point of contact with the industry for the joint discussion of matters of mutual interest. To the extent that such matters may be considered by this or any similar group, the meeting expressed the desire to offer its full cooperation in their discussion. It was pointed out by the committee that in many cases, members of such a group would be eligible for associate membership in the American Association of University Teachers of Insurance and that the present membership campaign is designed to inform them of their eligibility and to encourage applications for membership.

REPORT OF THE ELIZUR WRIGHT AWARD COMMITTEE

Dr. Frank G. Dickinson, Chairman of the Elizur Wright Award Committee, reported that the prize would not be awarded again this year because, in the opinion of the committee, no suitable contribution had appeared during the year.

Although not awarded this year or last, Dr. Dickinson pointed out this marked the fifth, and, under the terms of the original offer, the last year for which the award would be offered. The members approved unanimously a resolution expressing deep appreciation to the annonymous donor of the prize money given in connection with the award and directed the secretary to so inform the donor. The members also expressed the hope that the award might be renewed for another five years.

REPORT OF THE SPECIAL COMMITTEE ON THE JOURNAL

Dr. Hedges, chairman of the Special Committee on the *Journal*, reported that the pressure of other Association activities had prevented his initiating any action on the part of the *Journal* Committee. He pointed out, however, that he had some reservations regarding the desirability of initiating a more frequent publication program in view of the paucity of available material. As a partial solution to this program and as a first step in preparation for issuance of the *Journal* on a semi-annual or quarterly basis, he proposed the formation of a research committee which would endeavor to outline areas of research, suggest specific topics for research together with suitable techniques to be employed, and in general, promote the development of research, the results of which might eventually find an outlet in an expanded *Journal*. This proposal was discussed and adopted.

The Chairman suggested the possibility of making plans, in the meantime, to start the *Journal* on a modest scale. While there was some sentiment for delaying publication plans, final decision as to the action to be taken was left with the *Journal* Committee, subject to the concurrence of the Executive Committee. The committee was continued, with instructions to report any action taken or proposals for action at the next annual meeting.

ELECTION OF OFFICERS

The Nominating Committee presented its recommendations as follows: President, J. Anderson Fitzgerald; Vice President, Erwin A. Gaumnitz; Secretary-Treasurer, J. Edward Hedges; Member of Executive Committee, (term to expire in 1951) Clayton G. Hale. A motion was passed to declare the nominations closed and the nominees elected

COMMUNICATIONS FROM ABSENT MEMBERS

The secretary read expressions of good wishes from a number of absent members, who sent regrets at their inability to be present. Members from whom such communications had been received included Dr. S. S. Huebner, First President of the Association; Dr. Edison L. Bowers, Past President of the Association; Professor Sho-Zaburo Mori, of Tokyo, and Professor Paul Sumien of Paris, long-time honorary members, and Mr. H. A. L. Cockerell, Secretary, The Chartered Insurance Institute, of London, recently-elected honorary member. The meeting received with deep regret, news of the death some years ago of Professor Joshi ichi Miura, honorary member, conveyed to the secretary by Professor Mori.

RESOLUTIONS OF APPRECIATION

Professor Gaumnitz, the Vice President and Chairman of the Program Committee, informed the meeting of the serious illness of Mr. Breen which prevented his attendance at the meeting. As a member of the program committee, he had devoted much time and effort to the planning and arranging of the program and had a deep interest in many of the topics which were discussed. The members instructed the Secretary to take appropriate steps to convey to Mr. Breen their expression of sympathy and their good wishes for his speedy recovery.

A resolution was adopted expressing the appreciation of the Association for the splendid arrangements and facilities provided by Donald S. Thompson, Chairman of the Local Committee on arrangements of the Allied Social Science Associations.

A resolution of appreciation of the efforts of Mr. George W. Phypers, President, and Mr. S. J. Horton, Manager of the Cleveland Insurance Board, and of Mr. E. E. Evans, President of the Ohio Chapter of the American Society of Chartered Property and Casualty Underwriters, for their efforts in helping to make the meeting a success.

Appreciation was also expressed for the work of all those, both members and non-members, who participated in the program and to the officers for their work during the year.

Report

of

The Special Committe on Associate Membership and Related Matters

To:

Dean J. Anderson Fitzgerald, President, and members of the American Association of University Teachers of Insurance

Your Special Committee on Associate Membership and Related Matters appointed at the Annual Meeting in 1947 and continued for the year 1948 submits the following report:

The members of the committee were continued in office and at present consist of:

Mr. John M. Breen
Prof. Ralph H. Blanchard
Mr. E. J. Faulkner
Prof. J. Edward Hedges
Mr. Joy Lichtenstein
Prof. Hampton H. Irwin, Chairman

The principal function of the committee was to complete the membership drive on which progress was reported at the previous annual meeting. Because no new duties were assigned to the committee, and because it was merely a matter of implementing the instructions given the year previous, it was felt that no formal meeting of the committee would be necessary.

Accordingly, the details were handled by a three-way correspondence between Past President Kulp, Secretary Hedges and the Chairman, except that on occasion Professor Blanchard was counsulted before and after his trip abroad. A membership blank was drafted and approved by the members of this committee and the Executive Committee. Three sets of mailing lists were obtained— an academic list, a list for fire and casualty company presidents, and one for life insurance company presidents. The academic mailing list contained 650 names; the fire and casualty list has approximately 350 with about the same number of life company presidents. Dr. S. S. Huebner very graciously consented to sign the letters to the academic list and President John A. Stevenson of the Penn Mutual Life Insurance Company and an associate member of A.A.U.T.I. has agreed to have the letters to both the fire and casualty company presidents and to the life company presidents go out over his signature.

Since the letters refer specifically to the *Journal*, their actual processing had to be continually postponed due to unavoidable delays in getting the *Journal* ready for distribution. However, I am pleased to report that the letters have now gone out to the academic list and those to the other two lists will follow immediately.

With respect to both sets of company lists, it was felt that our purpose would be accomplished by sending the letters to the presidents of

the first 100 of the largest companies in each classification and in each case a complimentary copy of the *Journal* would be enclosed. Letters have been sent to the entire 650 on the academic list and although we did not feel we could include a complimentary copy of the *Journal* to so large a number, the letter invited the individual to write for a complimentary copy of the *Journal* if he wished to do so. It is interesting to note that although these letters were mailed only a very short time before our annual meeting, we already have received 20 memberships and in addition some 15 individuals have expressed their interest in the proposition.

Inasmuch as the project entrusted to the committee has now been completed, except for the mechanical details above noted which the Secretary will carry out in due course, we request that the Special Committee on Associate Membership and Related Matters be discharged.

Respectfully submitted,
HAMPTON H. IRWIN
Chairman, Special Committee on Membership
The American Association of University Teachers of Insurance
December 29, 1948

Treasurer's Report

January 1 to December 31, 1948, Inc.

INCOME

Cash on Hand, January 1, 1948			$ 468.21
Membership Dues		$ 795.00	
Sales of Proceedings:			
1947	$ 108.00		
Others	79.12	187.12	
Sales of Reprints		36.00	
Advertising in Proceedings:			
D. Appleton Century Co.	60.00		
Harvard University Press	45.00		
McGraw-Hill Book Co.	45.00		
Prentiss-Hall, Inc.	45.00		
Richard D. Irwin, Inc.	45.00		
Ronald Press Company	45.00		
Rough Notes Company, Inc.	45.00		
United States Review Pub. Co.	25.00		
Less discount	(13.50)	341.50	
Total Income			$1,359.62
Total Received from All Sources			$1,827.83

DISBURSEMENTS

Dunlap Printing Co. (Programs, 1937 Meeting)	$ 57.50	
Feltus Printing Co. (1000 copies of Journal, Reprints "Non-Gov. Med. Care.")	957.95	
Feltus Printing Co. (Stationery & Supplies)	99.35	
Miscellaneous Expenses of Secretary-Treasurer	192.82	
Bank Charges for Handling Account	2.74	
Typewriter Service, 1947 Meeting	3.25	
Total Disbursements		$1,313.61
Cash on Hand, December 31, 1948		$ 514.22

New Members[1]

1948-1949

ACTIVE

Adams, John F., C.L.U.
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Syracuse University
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Boyle, D. S.
Brigham Young University
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Brouder, Edward W.
Dir. of Training
Hartford Training Center
Hartford Acc. & Indem. Co.
Hartford, Connecticut

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Facultad De Commercio
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Jansen, George E.
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1. The complete membership roster was published in the March, 1948, issue of *The Journal*.

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Jenkins, L. Arthur
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Lang, Frank, Manager[2]
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University of Wisconsin
Madison 6, Wisconsin

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2 Omitted from the membership list of March, 1948 through error.

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